



State of Michigan
Comprehensive Annual Financial Report

Fiscal Year Ended September 30, 2002

JOHN ENGLER
Governor

NANCY W. DUNCAN
Acting State Budget Director
Office of the State Budget

MICHAEL J. MOODY, CPA
Director
Office of Financial Management

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Michigan

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JOHN ENGLER
GOVERNOR

STATE OF MICHIGAN
OFFICE OF THE STATE BUDGET
LANSING

NANCY W. DUNCAN
ACTING DIRECTOR

December 26, 2002

The Honorable John Engler, Governor
Members of the Legislature
People of the State of Michigan

As required by Article 9, Section 21, of the State Constitution and Section 494, Public Act 431 of 1984, as amended, we are pleased to submit the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)* for the fiscal year ended September 30, 2002.

INTRODUCTION TO THE REPORT

Responsibility: The Office of the State Budget, Office of Financial Management, prepares the SOMCAFR and is responsible for both the accuracy of the data and the completeness and fairness of the presentation, including disclosures. To the best of our knowledge and belief, the information contained in the SOMCAFR is accurate in all material respects and reported in a manner that fairly presents the financial position and results of operations of the State primary government and component units for which it is financially accountable. All disclosures necessary to enable the reader to gain a reasonable understanding of the State's financial affairs have been included.

Adherence to Generally Accepted Accounting Principles: As required by State statute, we have prepared the financial statements contained in the SOMCAFR in accordance with generally accepted accounting principles (GAAP) applicable to state and local governments, as promulgated by the Governmental Accounting Standards Board (GASB). The State also voluntarily follows the recommendations of the Government Finance Officers Association of the United States and Canada (GFOA) for the contents of government financial reports, and participates in the GFOA's review program for the Certificate of Achievement for Excellence in Financial Reporting.

Report: The SOMCAFR is divided into three major sections: introductory, financial, and statistical:

- The introductory section includes this letter, the State's organization chart, and the list of principal officials.
- The financial section includes: the independent auditor's report on the Basic Financial Statements; Management's Discussion and Analysis (MD&A) which provide an introduction, overview, and analysis to the Basic Financial Statements; the Basic Financial Statements, which present the government-wide financial statements and fund financial statements for governmental funds, proprietary funds, fiduciary funds, and component

units, together with footnotes to the Basic Financial Statements; Required Supplementary Information other than MD&A, which presents budgetary comparison schedules and information about infrastructure assets; and the supplemental financial data which includes the combining financial statements and schedules.

- The statistical section includes such items as trend information, information on debt levels, and other selected economic and statistical data.

Internal Control Structure: The Office of the State Budget is responsible for the overall operation of the State's central accounting system and for establishing and maintaining the State's internal control structure. All financial transactions of the State primary government are recorded in the central accounting system, except for the Michigan Unemployment Compensation Funds, the State Employees' Deferred Compensation Funds, and the State Employees' Defined Contribution Retirement Fund. Many of the essential control features are decentralized, such as the preparation and entry of expenditure transactions into the central accounting system. Consequently, the Office of the State Budget relies upon the controls in place at the various State departments and agencies. The Management and Budget Act (Section 18.1483 – 18.1489 of the *Michigan Compiled Laws*) requires the head of each principal department to establish and maintain an internal accounting and administrative control system. The Act also requires the heads of each principal department to report biennially on any material inadequacy or weakness discovered in connection with the evaluation of their system. The *"Evaluation of Internal Controls – A General Framework and System of Reporting"*, developed in consultation with the Office of the Auditor General, provides the required guidance associated with the evaluation of internal controls in Michigan State government. The framework for internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement.

The Management and Budget Act requires each principal department to appoint an internal auditor and to maintain adequate internal control systems. Each department is also required to periodically report to the Governor on the adequacy of its internal accounting and administrative control systems and, if any material weaknesses exist, to provide corrective action plans and time schedules for addressing such weaknesses. This reporting is required on or before May 1 of each odd numbered year, effective as of the preceding October 1.

The discretely presented component units generally operate outside the State's central accounting system and are responsible for establishing and maintaining their own separate internal control structures.

Independent Auditors: The Office of the Auditor General (OAG) audited the SOMCAFR with a goal to provide reasonable assurance that the SOMCAFR for the fiscal year ended September 30, 2002, is free of material misstatement. The OAG conducted its audit in accordance with generally accepted auditing standards (GAAS), and their report precedes the Basic Financial Statements. The audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the CAFR; assessing the accounting principles used, and evaluating the overall financial statement presentation. The OAG concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the SOMCAFR for the fiscal year ended September 30, 2002, is fairly presented in conformity with GAAP.

In addition to the annual audit of the SOMCAFR, the OAG also performs periodic financial and performance audits of the various State departments, agencies, and institutions of higher education. The OAG engages outside public accounting firms periodically, particularly for the audits of the separately issued component unit financial statements (such as the Michigan State Housing Development Authority), the larger pension (and other employee benefit trust) funds, and the Michigan Unemployment Compensation Funds. The Auditor General also has primary responsibility for conducting audits under the federal Single Audit Act of 1984. Pursuant to Michigan Public Act 251 of 1986, these audits are conducted biennially for applicable State departments, agencies, and component unit authorities, and result in separately issued audit reports.

Management's Discussion and Analysis (MD&A): GASB Statement No. 34 requires that management provide a narrative introduction, overview, and analysis to accompany the Basic Financial Statements in the form of MD&A. This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditor's Report.

PROFILE OF THE GOVERNMENT

Reporting Entity: The State of Michigan reporting entity reflected in the SOMCAFR, which is described more fully in Note 1 to the basic financial statements, conforms with the requirements of GASB Statement No. 14, The Financial Reporting Entity. The accounting and reporting principles contained in Statement No. 14 are based primarily on the fundamental concept that publicly elected officials are accountable to their constituents. Further, Statement No. 14 provides that the financial statements should emphasize the *primary government* and permit financial statement users to distinguish between the primary government and its *component units*. Consequently, the transmittal letter, MD&A, and the financial statements focus on the primary government and its activities. Although information pertaining to the discretely presented component units is provided, their separately issued financial statements should be read to obtain a complete overview of their financial position.

Budgetary Reporting and Control: For the State primary government operating funds (i.e., the General Fund and annually appropriated special revenue and permanent funds), Public Act 431 of 1984, as amended, requires the State to adhere to GAAP in budgeting projected revenues and expenditures and calculating fund balance for budgetary purposes. The Act also prohibits the State from budgeting for an ending fund balance deficit in an operating fund. If an actual deficit is incurred, the Constitution and Act 431 require that it be addressed in the subsequent year's budget. If accounting principles change, Act 431 requires the State to also implement such changes in its budgetary process.

The budgetary "basis of accounting" used by the State primary government departs from GAAP only in ways that do not affect unreserved fund balance, and that do not impact most revenue and expenditure line items. Appropriations for nearly all line items, therefore, are made on a basis consistent with GAAP, which makes it possible for the State to use the central accounting system for both budgetary control and financial reporting purposes. The two variances between GAAP and the budgetary basis of accounting are: 1) the use of encumbrances for budgetary control purposes (which GAAP does not require), and 2) the timing of recording expenditures and liabilities for capital lease commitments on a "pay as you go" basis for budgetary purposes, rather than at lease inception as required by GAAP. Compliance with the final updated budget for the annually budgeted operating funds of the State primary government is demonstrated in the budget and actual comparative schedules and notes in the SOMCAFR.

Revenue and Spending Limitation Requirements: Under the State Constitution, total State revenues are limited to a percentage of total Michigan personal income. If the limit is exceeded by an amount less than 1%, the excess may be transferred to the Budget Stabilization Fund. If revenues exceed the limit by 1% or more, the amount in excess must be refunded to payers of personal income and single business taxes. The calculations necessary to determine the State's compliance with this requirement for fiscal year 2001-2002 are not final. For fiscal year 2000-2001, the most recent year for which final calculations are available, total State revenues subject to this limitation were less than the limit by approximately \$2.4 billion. The State expects that total State revenues subject to the limitation will not exceed the limit for fiscal year 2001-2002.

The State Constitution also requires that spending to local units of government be maintained at not less than a specified level of total State spending, originally determined to be 41.61% for the base fiscal year 1978-79. The originally determined percentage was recalculated, effective fiscal year 1992-93, reflecting the terms of a legal settlement agreement. The recalculated base year percentage is 48.97%. The calculations necessary to determine the State's compliance with this requirement for fiscal year 2001-2002 are not final. For fiscal year 2000-2001, the most recent year for which final calculations are available, the proportion of total State spending paid to local units of government was determined to be 62.77%, reflecting payments that exceeded the minimum required by \$3.4 billion. The State expects that payments to local units of government will exceed the minimum requirement for fiscal year 2001-2002.

The State's status, with regard to these Constitutional provisions, is discussed more fully in Note 3 to the basic financial statements.

ECONOMIC CONDITIONS AND OUTLOOK

The U.S. economy fell into recession in fiscal year 2000-2001, and began its recovery in fiscal year 2001-2002. The recovery has been uneven. Businesses continued to reduce their equipment investment through mid 2002 and cut spending on new construction throughout the fiscal year. Consumer spending posted solid growth, buoyed by aggressive vehicle buying incentive programs and record mortgage refinancing. Consumer sentiment weakened toward the end of the fiscal year. Business confidence rebounded through the middle of the year but has since declined. The housing market remained strong.

Moderate economic growth and sharp increases in worker productivity restrained employment. U.S. employment fell sharply early in the fiscal year and was essentially flat since then. After falling at its fastest rate in a decade in fiscal year 2000-2001, U.S. light vehicle production rebounded somewhat in fiscal year 2001-2002. The manufacturing sector contracted in the fiscal year. Federal government actions have helped support the U.S. economy with sharp increases in spending and with extremely low interest rates. The stock market declined sharply again in fiscal year 2001-2002, finishing the year down about 20 percent.

Michigan's economy was slowed by the U.S. recession and sluggish recovery. Michigan wage and salary employment fell by about 60,000 in fiscal year 2001-2002, a 1.3 percent decline. Michigan's unemployment rate averaged 6.2 percent. Michigan personal income fell in early fiscal year 2001-2002 before rising over the second half. For the fiscal year as a whole, income was flat. Weak wage and salary income growth was reflected in fiscal year 2001-2002 income tax withholding. Slow calendar year 2001 personal income growth, coupled with sharp declines in the stock markets, sharply reduced fiscal year 2001-2002 quarterly and annual income tax payments in April 2002.

The most recent official State consensus economic forecast was prepared in May 2002. However, historical economic data and economic conditions have changed substantially since May. Thus, a more recent forecast likely provides a more accurate outlook. In November 2002, the Research Seminar in Quantitative Economics (RSQE) at the University of Michigan released its forecasts for the U.S. and Michigan economies through calendar year 2004. According to RSQE's November 2002 forecast, Michigan personal income growth is projected to accelerate from 3.5 percent in calendar year 2003 to 5.3 percent in 2004. RSQE projects inflation, as measured by the Detroit consumer price index, to remain moderate at 2.7 percent and 2.4 percent, respectively in 2003 and 2004. RSQE projects Michigan wage and salary employment to fall 0.3 percent in 2003 before rising 1.8 percent in 2004.

The Department of Treasury and House and Senate Fiscal Agencies will meet on January 14, 2003 to reach consensus on an official State forecast of the U.S. and Michigan economies at the January 2003 Consensus Revenue Estimating Conference.

MAJOR INITIATIVES AND FUTURE PROJECTS

Education Remains a Top Priority: Education continues to be one of the most significant investments of State resources. More than \$15.1 billion, or 38.3 percent, of the State's overall budget is devoted to education in fiscal year

2002-2003. This includes funding for the K-12 system, universities, community colleges and student financial aid. In fiscal year 2002, the State spent more on K-12 education than it spent on expenditures financed by General Fund general purpose revenues.

Health Care Services: The delivery of health care services consumed the second largest share of State resources. While the State administers a variety of health care programs, the Medicaid program is the most extensive. In fiscal year 2001-2002, over \$2 billion in General Fund resources and over \$4.0 billion in federal funds were dedicated to this program. These funds allowed the State to provide comprehensive health care services to over 1.2 million low-income Michigan citizens.

Transportation Infrastructure Investments: The State's Build Michigan I, II, and III financing programs have resulted in record investments in Michigan's transportation infrastructure. In fiscal year 2002-2003, the Department of Transportation will invest over \$1.0 billion in the state trunkline system. Since 1990, 14,500 miles of roads and nearly 1,900 bridges have been improved or repaired. Fiscal year 2002-2003 marks the sixth year in a row that the Michigan transportation program has exceeded the billion-dollar mark.

Technology Consolidation: Michigan's goal of being on the leading edge of technology, culminated with the creation of the Department of Information Technology in fiscal year 2001-2002. All technology management functions within the State are now housed within a single department, which allows for better management of technology investments, improved information management and more efficient services to citizens.

In addition, a survey by the *Center for Digital Government* and *The Progress & Freedom Foundation* rated Michigan as second in the nation for its impressive record of using digital technology to deliver high quality, convenient services to citizens and businesses.

Financial Management Reporting Improvements: The Office of the State Budget (OSB) led a statewide effort to reduce the time and cost of the annual bookclosing process that produces the SOMCAFR. OSB's publication of this report, with an unqualified audit opinion, marked the quickest a state has ever released its Comprehensive Annual Financial Report. This accomplishment required a collaborative effort from accounting and financial personnel throughout State government.

FINANCIAL INFORMATION

The MD&A provides an overview of the State's financial activities addressing both governmental and business-type activities reported in the government-wide financial statements. In addition, MD&A focuses on the State's major funds: the General Fund, Budget Stabilization Fund, School Aid Fund, State Lottery Fund, and the Michigan Unemployment Compensation Funds. Fiduciary activities are excluded from the MD&A.

Cash Management and Investments: As discussed more fully in Notes 5 and 8 to the basic financial statements, the State Treasurer maintains the State's Common Cash pool, which is used by most State funds for short-term investments and to provide centralized control over disbursements. The total amount of pooled cash, which is primarily invested in prime commercial paper, amounted to \$3.2 billion at

September 30, 2002, a decrease of approximately \$1.6 billion (34.0 percent) from \$4.8 billion at September 30, 2001. Total investments amounted to \$46.7 billion at September 30, 2002, a decrease of \$7.0 billion (13.0 percent) from \$53.7 billion at September 30, 2001. Pension (and other employee benefits) trust fund investments represent 91.4 percent of the total investments held by the State.

Debt Management: The State Constitution authorizes general obligation long-term borrowing, subject to approval by the Legislature and a majority of voters at a general election. General obligation bond issues totaled \$455.1 million during 2001-2002. The bonds provided financing to pay off the principle of previously issued bonds that carried higher interest rates (commonly known as refunding), and provided financing for the Clean Michigan Initiative and school district loans.

Long-term bonds have been issued periodically for specific purposes, such as constructing new State and university facilities and road and bridge construction. Funding of the debt requirements is to come strictly from designated revenue sources. Revenue dedicated bonded debt issuances, including that of the State Building Authority, totaled \$820.9 million during 2001-2002, resulting in a total of \$3.9 billion outstanding at year-end.

The State Constitution provides that the Legislature may authorize the issuance of short-term general obligation notes to assist in managing cash flows. Such borrowings are limited by the Constitution to 15% of undedicated State revenue received in the preceding year. The Constitution also requires that such borrowings be repaid before year-end. No such borrowings occurred during the fiscal year.

Additional disclosures about the State's general long-term obligations are provided in Note 12 to the basic financial statements.

Pension Plans: The State Constitution requires the State to provide current funding of plan benefits for the State's defined benefit pension plans. Statutes provide for the amortization of unfunded prior service costs. In two of the four plans for which the State is responsible for providing funding, the enabling statutes for the plans contain provisions under which a shortfall in the legally required contributions will be corrected in succeeding fiscal years.

The State Employees' Retirement System (SERS) is the largest of the defined benefit plans for which the State is responsible for providing funding. Total assets of SERS at September 30, 2002 were \$8.8 billion, with net assets held in trust for pension and postemployment health-care benefits

totaling \$8.4 billion. Additional disclosures relating to the State's pension funds are provided in Note 10 to the financial statements.

Risk Management: Risk management was established within the Department of Management and Budget in 1987 to improve the State's risk control policies and procedures. The unit's activities include analysis of and control over insurance coverage and risk exposure, and planning and implementing a statewide safety and health policy and program. The State is self-insured for many types of general liability and property losses. Additional disclosures on the State's risk management activities are provided in Note 24.

OTHER INFORMATION

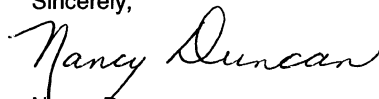
Certificate of Achievement: The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Michigan for its SOMCAFR for the year ended September 30, 2001. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports.

To be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

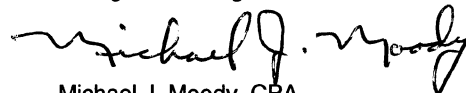
A Certificate of Achievement is valid for a period of one year only. The State has received a Certificate of Achievement for 15 consecutive years. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA for review.

Acknowledgments: In any year, the preparation of this report requires the collective efforts of literally hundreds of finance personnel throughout the State, both individually and in teams from virtually all agencies and departments. We sincerely appreciate the dedicated efforts of all of these individuals. This year we are particularly proud of the efforts necessary to publish the CAFR within 90 days. Achieving this was the result of the dedicated management and staff of the Financial Control Division, Office of Financial Management; the chief financial officers, chief accountants, and their staffs of all State agencies; and the management and staff of the Office of the Auditor General, all of whom continue to strive for improvements that will result in Michigan being a national leader in quality and efficiency for financial reporting.

Sincerely,



Nancy Duncan
Acting State Budget Director



Michael J. Moody, CPA
Director, Office of Financial Management

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of
Michigan

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
September 30, 2001

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



A handwritten signature in black ink, reading "William Patrick Bate".

President

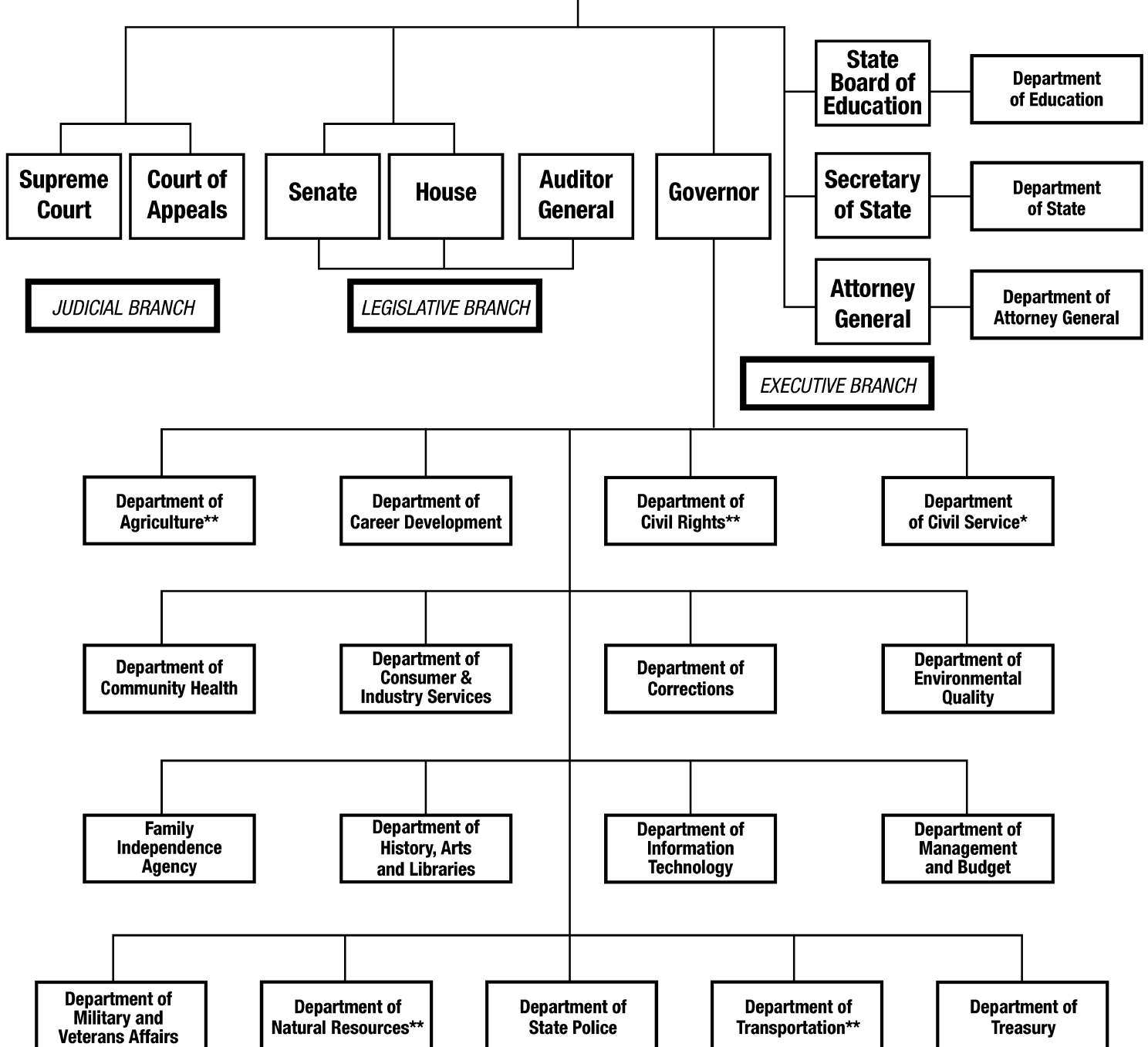
A handwritten signature in black ink, reading "Jeffrey R. Emer".

Executive Director

STATE OF MICHIGAN

ORGANIZATIONAL STRUCTURE

SEPTEMBER 30, 2002



* Has Commission appointed by Governor

** Has Commission appointed by Governor, confirmed by Senate

STATE OF MICHIGAN
PRINCIPAL STATE OFFICIALS

JUDICIAL BRANCH

Supreme Court Justices
Honorable Maura D. Corrigan, Chief Justice
Honorable Michael F. Cavanagh, Justice
Honorable Marilyn Kelly, Justice
Honorable Stephen J. Markman, Justice
Honorable Clifford W. Taylor, Justice
Honorable Elizabeth A. Weaver, Justice
Honorable Robert P. Young, Jr., Justice

LEGISLATIVE BRANCH

Honorable Dick Posthumus
President of the Senate

Honorable Rick V. Johnson
Speaker of the House of Representatives

Thomas H. McTavish
Legislative Auditor General

EXECUTIVE BRANCH

Honorable John Engler, Governor

Honorable Jennifer M. Granholm, Attorney General

Honorable Candice S. Miller, Secretary of State

State Board of Education
Kathleen N. Straus, President
John C. Austin
Sharon L. Gire
Marianne Yared McGuire
Herbert S. Moyer
Michael D. Warren, Jr.
Eileen L. Weiser
Sharon A. Wise
Honorable John Engler (Ex Officio)
Thomas D. Watkins, Jr.,
Superintendent of Public Instruction

Michigan Commission of Agriculture
Douglas E. Darling, Chair
James E. Maitland
William Pridgeon
Jordan B. Tatter
Nora M. Viau
Dan Wyant, Director, Department of Agriculture

Barbara Bolin, Director
Department of Career Development

Civil Rights Commission
Gary Torgow, Chair
Bishop George Brown
Albert Calille
Evelyn L. Crane
Yahya Mossa Basha
Valerie P. Simmons
Francisco J. Villarruel
Tarun K. Sharma
Nanette Lee Reynolds, Director, Department of Civil Rights

Civil Service Commission
Susan Grimes Munsell, Chair
Robert P. Hunter
Sherry L. McMillan
James P. Pitz
John F. Lopez, Director, Department of Civil Service

James K. Haveman, Jr., Director
Department of Community Health

Noelle Clark, Director
Department of Consumer and Industry Services

William S. Overton, Director, Department of Corrections

Russell J. Harding, Director
Department of Environmental Quality

Douglas E. Howard, Director
Family Independence Agency

William Anderson, Director
Department of History, Arts and Libraries

Jacque Passino, Director
Department of Information Technology

Duane E. Berger, Director
Department of Management and Budget

Nancy W. Duncan, Acting State Budget Director
Office of the State Budget

Major General E. Gordon Stump, Director
Department of Military and Veterans Affairs

Natural Resources Commission
Keith J. Charters, Chair
Jim Campbell
Nancy A. Douglas
Paul J. Eisele
Bob Garner
William U. Parfet
Frank C. Wheatlake
K. L. Cool, Director, Department of Natural Resources

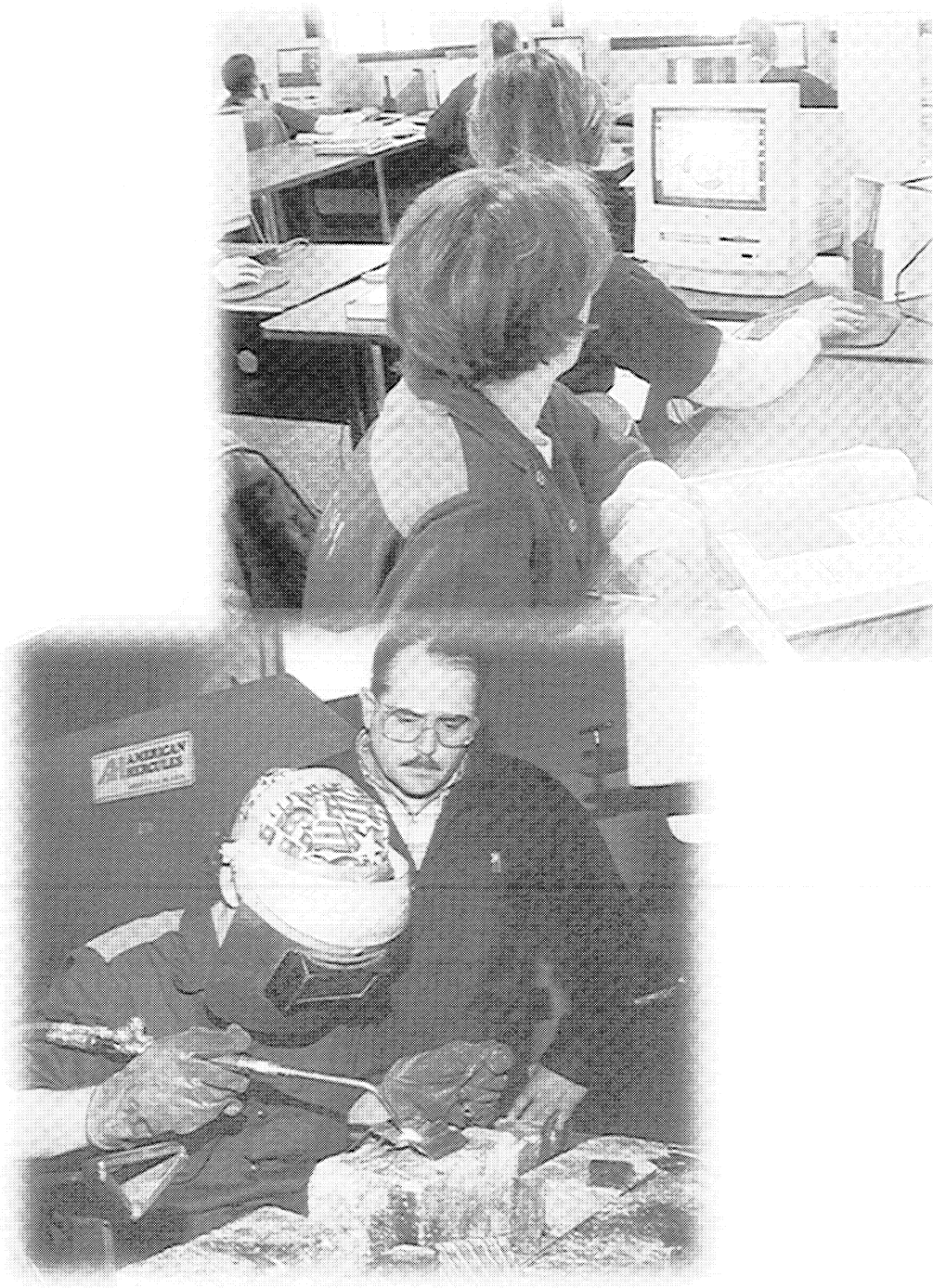
Col. Stephen D. Madden, Director
Department of State Police

Transportation Commission
Barton W. LaBelle, Chair
Betty Jean Awrey
C. Robert Baillod
John W. Garside
Lowell B. Jackson
Ted B. Wahby
Gregory J. Rosine, Director, Department of Transportation

Douglas B. Roberts, State Treasurer



Michigan corrections officers are among the best trained in the nation. The Department of Corrections requires completion of 620 hours of classroom and on-the-job training. Certain specially-trained officers and other staff can be chosen to represent the department at ceremonial functions.

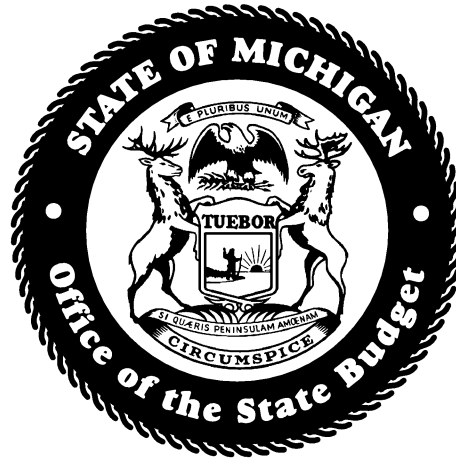


TOP:

The Michigan Department of Corrections provides Adult Basic Education and GED completions throughout the system, as well as special education courses. The number of prisoners earning GEDs has steadily increased. The State does not pay for college classes for prisoners, but they are able to take correspondence courses at their own expense.

BOTTOM:

The department stresses completion of a GED before parole and encourages enrollment in vocational programs which include: building trades, business education, visual graphic technology, horticulture, welding, introduction to computers, auto mechanics, and machine tool operations.



II FINANCIAL SECTION

INDEPENDENT AUDITOR'S REPORT BASIC FINANCIAL STATEMENTS



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report

The Honorable John M. Engler, Governor
Members of the Legislature

December 26, 2002

We have audited the accompanying basic financial statements of the State of Michigan, principally as of September 30, 2002 and for the year then ended, listed in the foregoing table of contents. These basic financial statements are the responsibility of the State's management. Our responsibility is to express an opinion on these basic financial statements based on our audit. We did not audit the financial statements of the State Lottery Fund, Michigan Unemployment Compensation Funds, Michigan Employment Security Act - Administration Fund, State Building Authority - Debt Service Fund, State Building Authority - Capital Projects Fund, State Sponsored Group Insurance Fund, State Employees' Deferred Compensation Funds, State Police Retirement Fund, State Employees' Retirement Fund, Public School Employees' Retirement Fund, Judges' Retirement Fund, State Employees' Defined Contribution Retirement Fund, Michigan Education Savings Program, Michigan State Housing Development Authority, Michigan Municipal Bond Authority, Michigan Higher Education Facilities Authority, Mackinac Bridge Authority, Michigan State Hospital Finance Authority, Michigan Higher Education Student Loan Authority, Michigan Higher Education Assistance Authority, Mackinac Island State Park Commission, State Bar of Michigan, Central Michigan University, Western Michigan University, Eastern Michigan University, Ferris State University, Grand Valley State University, Lake Superior State University, Michigan Technological University, Northern Michigan University, Oakland University, and Saginaw Valley State University. Those financial statements reflect total assets and revenues of the government-wide financial statements and total assets and revenues or additions of the fund financial statements as follows:

<u>Government-Wide Financial Statements:</u>	<u>Percent of Assets</u>	<u>Percent of Revenues</u>
Primary Government - Governmental Activities	2.2%	2.2%
Primary Government - Business-Type Activities	98.4%	82.4%
Component Units	97.4%	91.0%

<u>Fund Financial Statements:</u>	<u>Percent of Assets</u>	<u>Percent of Revenues or Additions</u>
Governmental Funds - Non-Major Funds	9.8%	3.1%
Proprietary Funds - Business-Type Activities - Enterprise Funds - State Lottery Fund	100.0%	100.0%
Proprietary Funds - Business-Type Activities - Enterprise Funds - Michigan Unemployment Compensation Funds	100.0%	100.0%
Proprietary Funds - Governmental Activities - Internal Service Funds	58.6%	52.0%
Fiduciary Funds - Pension (and Other Employee Benefit) Trust Funds	99.7%	99.7%
Fiduciary Funds - Private Purpose Funds	74.3%	64.7%
Component Units	97.4%	91.0%

Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those component units and funds, is based solely upon the reports of the other auditors.



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

The Honorable John M. Engler, Governor
Members of the Legislature
Page 2

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe our audit and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our report and the reports of other auditors, the basic financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the State of Michigan, principally as of September 30, 2002, and the results of its operations and the cash flows of its proprietary fund types for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The combining and individual fund statements and schedules - non-major funds listed in the foregoing table of contents, which are also the responsibility of the State's management, are presented for purposes of additional analysis and are not a required part of the basic financial statements of the State of Michigan. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and in the audits performed by other auditors and, in our opinion, based on our audit and the reports of other auditors, is fairly presented, in all material respects, in relation to the basic financial statements taken as a whole.

The management's discussion and analysis on pages 5 through 12, budgetary comparison schedules and corresponding notes on pages 82 through 85, and information about infrastructure assets reported using the modified approach on pages 86 and 87 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

The introductory and statistical sections listed in the foregoing table of contents were not audited by us and, accordingly, we express no opinion on them.

Sincerely,

A handwritten signature in black ink, appearing to read "Thomas H. McTavish", with a large, stylized loop at the end.

Thomas H. McTavish, C.P.A.
Auditor General



MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a discussion and analysis of the State of Michigan's (the State's) financial performance, providing an overview of the activities for the fiscal year ended September 30, 2002. Please read it in conjunction with the transmittal letter at the front of this report and with the State's financial statements, which follow this section.

HIGHLIGHTS

Government-wide:

- Although the State's net assets decreased by \$2.6 billion from the previous year-end, its assets still exceeded its liabilities by \$19.9 billion as of the close of the fiscal year. Component units reported net assets of \$4.4 billion, an increase of \$133.5 million (or 3.1 percent) from the previous year.

Fund Level:

- As of the close of the fiscal year, the State's governmental funds reported combined ending fund balances of \$4.5 billion, with \$1.4 billion reported as *unreserved fund balance* and the remaining amount of \$3.1 billion reserved for specific purposes, such as education and transportation. At the end of the fiscal year, unreserved fund balance for the General Fund was \$114.5 million.
- The proprietary funds reported net assets at year-end of \$2.7 billion, a decrease of \$540.7 million (or 16.7 percent) during the year.

Long-term Debt:

- The State's total debt rose during the fiscal year to \$5.9 billion, an increase of \$744.6 million, which represents the net difference between new issuances, and payments and refundings of outstanding debt. During the year the State issued bonds (\$1.3 billion), notes (\$200.0 million), and commercial paper (\$2.3 billion).

More detailed information regarding the government-wide, fund level, and long-term debt activities can be found beginning on page 7.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is an introduction to the State's basic financial statements, which comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements.

Government-wide Statements (Reporting the State as a Whole)

The Statement of Net Assets and the Statement of Activities are two financial statements that report information about the State, as a whole, and about its activities that should help answer this question: How has the State's financial position, as a whole, changed as a result of this year's activities? These statements include all non-fiduciary assets and liabilities using the accrual basis of accounting. The current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Net Assets (pages 14 and 15) presents all of the State's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets measure whether the State's financial position is improving or not.

The Statement of Activities (pages 16 and 17) presents information showing how the State's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods (e.g. uncollected taxes and earned but unused vacation leave).

Both statements report three activities:

- *Governmental Activities* – Most of the State's basic services are reported under this category. Taxes and intergovernmental revenues generally fund these services. The Legislature, the Judiciary, and the general operations of the Executive departments fall within the governmental activities.

- *Business-type Activities* – The State charges fees to customers to help it cover all or most of the cost of certain services it provides. Lottery tickets, liquor purchases, and the State's unemployment compensation services are examples of business-type activities.
- *Discretely Presented Component Units* – Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The State has 14 authorities and 10 universities that are reported as discretely presented component units of the State.

This report includes two schedules (pages 21 and 23) that reconcile the amounts reported on the governmental fund financial statements (modified accrual accounting) with governmental activities (accrual accounting) on the appropriate government-wide statements. The following summarizes the impact of transitioning from modified accrual to accrual accounting:

- Capital assets used in governmental activities are not reported on governmental fund statements.
- Certain tax revenues that are earned, but not available, are reported as governmental activities, but are reported as deferred revenue on the governmental fund statements.
- Other long-term assets that are not available to pay for current period expenditures are deferred in governmental fund statements, but not deferred on the government-wide statements.
- Internal service funds are reported as governmental activities, but reported as proprietary funds in the fund financial statements.
- Certain pension trust funds have been funded in excess of their annual required contribution. These assets are recorded only in the government-wide statements.
- Deferred issue costs are capitalized and amortized as governmental activities, but reported as expenditures in the governmental fund statements.
- Unless due and payable, long-term liabilities, such as capital lease obligations, compensated absences, litigation, bonds and notes payable, and others only appear as liabilities in the government-wide statements.
- Capital outlay spending results in capital assets on the government-wide statements, but are reported as expenditures on the governmental fund statements.
- Bond and note proceeds result in liabilities on the government-wide statements, but are recorded as other financing sources on the governmental fund statements.
- Certain other outflows represent either increases or decreases in liabilities on the government-wide statements, but are reported as expenditures on the governmental fund statements.

The Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found beginning on page 41 of this report.

Fund Financial Statements (Reporting the State's Major Funds)

The fund financial statements begin on page 20 and provide detailed information about the major individual funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the State uses to keep track of specific sources of funding and spending for a particular purpose. In addition to the major funds, page 92 begins the individual fund data for the non-major funds. The State's funds are divided into three categories – governmental, proprietary, and fiduciary – and use different accounting approaches.

- *Governmental funds* -- Most of the State's basic services are reported in the governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for future spending. The governmental fund financial statements provide a detailed short-term view of the State's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the State's programs. These funds are reported using *modified accrual* accounting, which measures cash and all other financial assets that can readily be converted to cash. Governmental funds include the General Fund and special revenue, capital project, debt service, and permanent funds.
- *Proprietary funds* -- When the State charges customers for the services it provides, whether to outside customers or to other agencies within the State, these services are generally reported in proprietary funds. Proprietary funds (enterprise and internal service) utilize accrual accounting, the same method used by private sector businesses. Enterprise funds report

activities that provide supplies and services to the general public. An example is the State Lottery Fund. Internal service funds report activities that provide supplies and services for the State's other programs and activities - such as the State's Vehicle and Travel Services. Internal service funds are reported as governmental activities on the government-wide statements.

- **Fiduciary funds** -- The State acts as a trustee or fiduciary for its employee pension plans. It is also responsible for other assets that, because of a trust arrangement, can be used only for the trust beneficiaries. The State's fiduciary activities are reported in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets beginning on page 32. These funds, which include pension (and other employee benefit), private-purpose, and agency funds, are reported using accrual accounting. The government-wide statements exclude fiduciary fund activities and balances because these assets are restricted in purpose and do not represent discretionary assets of the State to finance its operations.

Additional Required Supplementary Information

Following the basic financial statements is additional Required Supplementary Information that further explains and supports the information in the financial statements. The Required Supplementary Information includes budgetary comparison schedules reconciling the statutory and generally accepted accounting principles (GAAP) fund balances at fiscal year-end, and condition and maintenance data regarding certain portions of the State's infrastructure.

Other Supplementary Information

Other supplementary information includes combining financial statements for non-major governmental, proprietary, and fiduciary funds, and non-major discretely presented component units. These funds are added together, by fund type, and presented in single columns in the basic financial statements, but are not reported individually, as with major funds, on the governmental fund financial statements.

FINANCIAL ANALYSIS OF THE GOVERNMENT AS A WHOLE

The State's combined net assets decreased \$2.6 billion (or 11.4 percent) over the course of this fiscal year's operations. The net assets of the governmental activities decreased \$2.0 billion (or 10.4 percent) and business-type activities had a decrease of \$559.3 million (or 17.9 percent).

Changes in Net Assets For Fiscal Year Ending September 30 (In Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2002	2001	2002	2001	2002	2001
Current and other non-current assets	\$10,458.9	\$12,420.6	\$ 3,598.6	\$ 4,219.9	\$14,057.5	\$16,640.4
Capital assets	18,349.9	17,750.5	.4	.3	18,350.3	17,750.8
Total assets	28,808.8	30,171.1	3,599.0	4,220.1	32,407.9	34,391.2
Current liabilities	4,343.5	4,180.8	430.3	431.8	4,773.9	4,612.5
Long-term liabilities	7,095.3	6,606.5	599.9	660.3	7,695.2	7,266.8
Total liabilities	11,438.9	10,787.3	1,030.2	1,092.0	12,469.1	11,879.3
Net assets:						
Invested in capital assets, net of related debt	15,014.8	15,129.8	.4	.3	15,015.3	15,130.1
Restricted	2,016.6	2,849.2	2,563.9	3,121.4	4,580.5	5,970.6
Unrestricted	338.6	1,404.8	4.4	6.4	343.0	1,411.2
Total net assets	\$17,370.0	\$19,383.8	\$ 2,568.8	\$ 3,128.1	\$19,938.7	\$22,511.9

The largest component (75.3 percent) of the State's net assets reflects its investment in capital assets (e.g. land, buildings, equipment, infrastructure, and others), less any related debt outstanding that was needed to acquire or construct the assets. Restricted net assets are the next largest component, comprising 23.0 percent. These represent resources that are subject to external restrictions, constitutional provisions, or enabling legislation on how they can be used. The remaining portion, unrestricted net assets, may be used at the State's discretion, but often have limitations on use based on State statutes.

Michigan

The following condensed financial information was derived from the government-wide Statement of Activities and reflects how the State's net assets changed during the fiscal year:

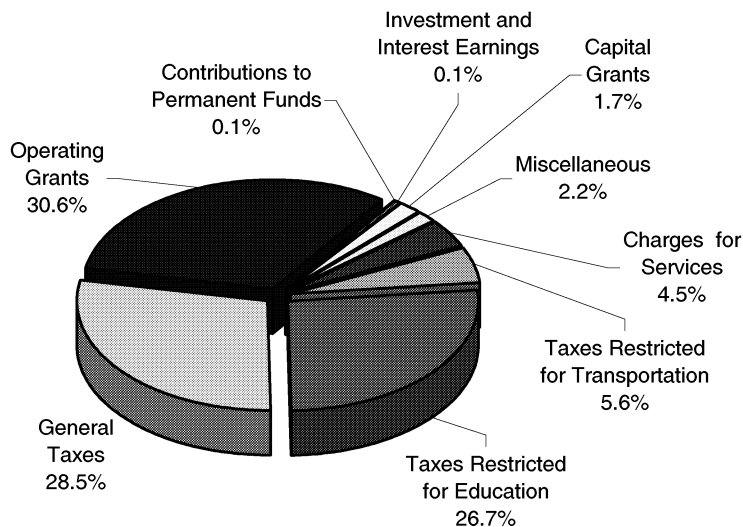
Changes in Net Assets For Fiscal Year Ending September 30 (In Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2002	2001	2002	2001	2002	2001
Revenues						
Program revenues						
Charges for services	\$ 1,608.9	\$ 1,496.9	\$ 3,764.1	\$ 3,297.9	\$ 5,373.0	\$ 4,794.8
Operating grants	10,848.7	10,255.3	535.5	313.6	11,384.2	10,569.0
Capital grants	589.5	667.4	-	-	589.5	667.4
General revenues						
General taxes	10,099.5	11,425.7	10.7	10.4	10,110.2	11,436.2
Taxes restricted for educational purposes	9,481.0	9,500.3	-	-	9,481.0	9,500.3
Taxes restricted for transportation purposes	2,002.6	1,936.3	-	-	2,002.6	1,936.3
Investment and interest earnings	51.7	159.2	1.6	4.2	53.2	163.4
Miscellaneous	790.9	669.0	-	-	790.9	669.0
Total revenues	35,472.8	36,110.1	4,311.9	3,626.2	39,784.7	39,736.3
Expenses						
General government	1,560.1	1,735.2	-	-	1,560.1	1,735.2
Education	14,696.1	14,109.6	-	-	14,696.1	14,109.6
Family independence services	3,792.1	3,627.8	-	-	3,792.1	3,627.8
Public safety and corrections	2,161.5	2,098.6	-	-	2,161.5	2,098.6
Conservation, environment, recreation, and agriculture	691.8	682.9	-	-	691.8	682.9
Labor, commerce, and regulatory	898.2	884.1	-	-	898.2	884.1
Health services	8,952.4	8,536.0	-	-	8,952.4	8,536.0
Transportation	3,268.2	2,766.7	-	-	3,268.4	2,766.7
Tax expenditures	615.1	532.8	-	-	615.1	532.8
Intergovernmental - revenue sharing	1,517.3	1,555.8	-	-	1,517.3	1,555.8
Interest on long-term debt	248.3	221.3	-	-	248.3	221.3
Liquor Purchase Revolving Fund	-	-	494.7	479.4	494.7	479.4
State Lottery Fund	-	-	1,153.3	1,132.8	1,153.3	1,132.8
Michigan Unemployment Compensation Funds	-	-	2,328.7	1,485.9	2,328.7	1,485.9
Total expenses	38,401.1	36,750.8	3,976.7	3,098.1	42,377.8	39,848.9
Excess (deficiency) Before Contributions and Transfers	(2,928.3)	(640.7)	335.2	528.1	(2,593.1)	(112.6)
Contributions to permanent fund principal	19.9	38.4	-	-	19.9	38.4
Transfers	894.5	737.6	(894.5)	(737.6)	-	-
Increase (decrease) in net assets	(2,013.8)	135.4	(559.3)	(209.5)	(2,573.1)	(74.2)
Net assets – beginning	19,383.8	19,248.4	3,128.1	3,337.6	22,511.9	22,586.0
Net assets – ending	\$17,370.0	\$19,383.8	\$ 2,568.8	\$ 3,128.1	\$19,938.7	\$22,511.8

Governmental Activities:

The following chart depicts revenues of the governmental activities for the fiscal year:

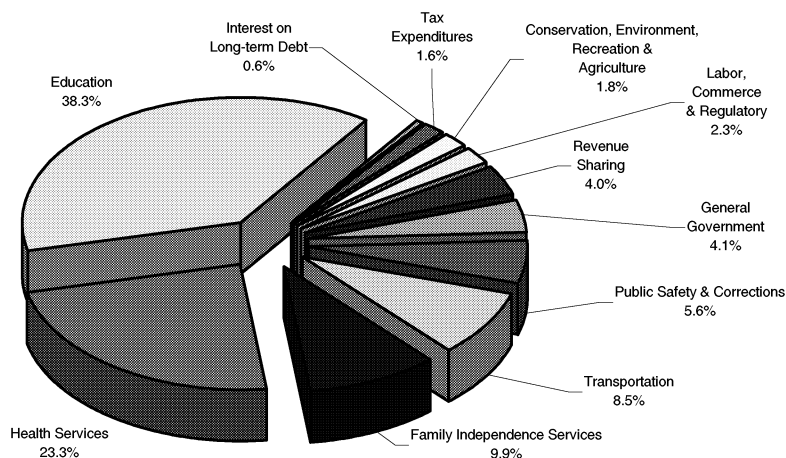
Revenues - Governmental Activities
Fiscal Year Ending September 30, 2002



Revenues for the State's governmental activities are likely to decrease in the coming years as the personal income and single business tax rates gradually decline. By law, the personal income tax rate (currently 4.1%) is reduced by 0.1% each January 1 until the rate reaches 3.9%. Similarly, the single business tax rate (currently 1.9%) is reduced by 0.1% each January 1 if the Budget Stabilization Fund balance on the previous September 30 was greater than \$250 million. Decreases in tax revenues during the current fiscal year resulted from these tax rollbacks, in addition to the slowdown in the economy. Because the September 30, 2002 Budget Stabilization Fund balance is less than \$250 million, the single business tax rate will not be reduced on January 1, 2003.

The following chart depicts expenses of the governmental activities for the fiscal year:

Expenses - Governmental Activities
Fiscal Year Ending September 30, 2002



Business-type Activities

Net assets of the business-type activities decreased by \$559.3 million (or 17.9 percent) during the fiscal year. Factors contributing to these results included:

- The increase in unemployment in the State resulted in the Michigan Unemployment Compensation Funds finishing the fiscal year with a decrease in net assets of \$589.9 million (or 19.5 percent) to \$2.4 billion.
- The State Lottery Fund's net assets increased by \$32.4 million (or 33.8 percent), which resulted from an increase in the market value of investments that Lottery holds to fund future payments due on annuitized lottery prizes.

FINANCIAL ANALYSIS OF THE STATE'S FUNDS

As the State completed the year, its governmental funds reported fund balances of \$4.5 billion. Of this total amount, \$1.4 billion constitutes unreserved fund balance, which is available for appropriation for the general purposes of the funds. The General Fund (\$114.5 million), the School Aid Fund (\$237.0 million), the Budget Stabilization Fund (\$145.2 million), and transportation-related funds (\$501.6 million) comprise a significant portion of the unreserved fund balance. The remainder of fund balance is reserved and is not available for new spending because it has already been dedicated for various commitments, such as capital outlay projects.

General Fund

The General Fund is the chief operating fund of the State. At the end of current fiscal year 2001-2002, unreserved fund balance of the General Fund was \$114.5 million and reserved fund balance was \$1.7 billion. Total fund balance diminished during the fiscal year by \$131.4 million (or 6.9 percent), primarily because of lower tax collections during the economic recession.

General Fund Budgetary Highlights:

The State's changes in the projected inflows were consistent with the national economic condition. In November 2001, the Governor issued Executive Order 2001-9, authorizing expenditure reductions totaling \$319.2 million and transfers of unexpended balances and excess revenues from restricted revenue sources totaling \$144.6 million to be used as general fund – general purpose revenues. In May 2002, the official State consensus economic forecast documented the continuing decline in State revenues. As a result, the original budget was amended by various supplemental appropriations and appropriation reductions. The following summarizes the differences between the original and final budget amounts:

- General purpose tax revenues of \$8.1 billion were less than the original estimate of \$9.0 billion.
- Restricted revenue inflows of \$13.4 billion were greater than the estimated \$12.8 billion.
- The Budget Stabilization Fund transferred \$452.8 million to the General Fund, \$297.8 million more than was originally budgeted.

Differences between the final budget and actual spending result from spending authority lapses of \$85.0 million, over-expended appropriations of \$1.6 million, and restricted revenue authorized but not spent of \$6.4 million.

Overall, there were no net overexpenditures by General Fund departments. There were, however, the following line-item overexpenditures of State funds incurred during the year:

Community Health	\$.1 million
Family Independence Agency	\$1.5 million

General Fund revenues will experience reduced revenues in the next fiscal year. Corresponding reductions in spending and other measures will help ensure that the fund balance remains positive.

School Aid Fund

Fund balance at September 30, 2002, totaled \$241.9 million, a decrease of \$462.2 million (or 65.6 percent) from the prior year. Revenues and transfers to the fund totaled \$10.9 billion. Expenditures to school districts and other costs increased by \$415.1 million (or 3.8 percent) from the previous year and totaled \$11.4 billion.

Counter-cyclical Budget and Economic Stabilization Fund

Fund balance at September 30, 2002 decreased to \$145.2 million, from \$994.2 million the previous year. The downturn in the economy required an increase in transfers from the fund to assist the State in balancing its budget. During fiscal year 2002-2003, the State anticipates that transfers from the fund will further reduce the fund balance.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets: At the end of the fiscal year 2001-2002, the State had invested \$18.4 billion, net of accumulated depreciation, in a broad range of capital assets (see the table below). Depreciation charges for this fiscal year totaled \$178.1 million.

Capital Assets as of September 30
(Net of Depreciation, In Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2002	2001	2002	2001	2002	2001
Land	\$ 3,082.4	\$ 3,093.3	\$	\$ -	\$ 3,082.4	\$ 3,093.3
Land improvement	68.3	56.2		-	68.3	56.2
Buildings and improvements	1,997.3	1,714.5		-	1,997.3	1,714.5
Equipment	202.3	193.1	.4	.3	202.7	193.4
Infrastructure	11,766.1	11,810.4		-	11,766.1	11,810.4
Other	18.9	20.7		-	18.9	20.7
Subtotal	17,135.3	16,888.2	.4	.3	17,135.7	16,888.5
Construction in progress	1,214.6	862.3		-	1,214.6	862.3
Total	\$18,349.9	\$17,750.5	\$.4	\$.3	\$18,350.3	\$17,750.8

The most significant impact on capital assets during the year resulted from the completion of the Hall of Justice and continued road and bridge projects.

As allowed by GASB Statement No. 34, the State has adopted an alternative process for recording depreciation expense on selected infrastructure assets. Under this alternative method, referred to as the modified approach, the State expenses certain maintenance and preservation costs and does not report depreciation expense. Assets accounted for under the modified approach include approximately 27,400 lane miles of roads, 4,600 bridges (spans greater than 20 feet), and 1,100 other spans that the State is responsible to maintain.

The State has consistently improved the assessed condition of roads over the past five years. The State's goal is to have no more than 30% of roads in "poor" or "very poor" condition. The most recent condition assessment, completed for calendar year 2001, indicated that 22% of roads were considered poor or very poor.

The State's bridges have assessed conditions that are better than the established benchmarks. The most recent assessment (2001) indicated that the condition of the bridges had improved from the condition reported for 2000.

The State's fiscal year 2002-2003 capital outlay budget projects spending \$576.7 million for new projects at Michigan colleges and universities, and special maintenance projects at various state agency buildings, in addition to \$299.7 million of unspent capital outlay authorizations that existed at September 30, 2002. More detailed information about the State's capital assets is presented in Note 9 to the financial statements.

Long-term Debt: The State, along with the State Building Authority (SBA), a blended component unit of the State, are empowered by law to authorize, issue, and sell debt obligations. General obligation bonds, issued by the State, are backed by the full faith and credit of the State. The State also issues revenue dedicated bonded debt, whose payment for principal and interest comes solely out of funds that receive legally restricted revenues. The State is not legally obligated for the debt issued by SBA. SBA's bonds generate revenue to finance the construction of facilities used by the State and universities. Revenues derived from leases on the facilities fund the debt service requirements. More detailed information regarding the State's long-term obligations is presented in Notes 12 and 14 to the financial statements.

Michigan

Outstanding Bonded Debt as of September 30 (In Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2002	2001	2002	2001	2002	2001
General obligation bonds (backed by the State)	\$1,119.6	\$1,031.8	\$ -	\$ -	\$1,119.6	\$1,031.8
Revenue bonds and notes (backed by specific tax and fee revenues)	3,907.7	3,433.3	-	-	3,907.7	3,433.3
Total	\$5,027.2	\$4,465.1	\$ -	\$ -	\$5,027.2	\$4,465.1

During fiscal year 2001-2002 the State issued general obligation debt totaling \$455.1 million, including \$300.7 million to pay off amounts outstanding on previously issued bonds that carried higher interest costs, \$56.8 million of bonds to fund conservation and recreation projects, and \$97.7 million of bonds to provide funds to loan to school districts.

Bond Ratings

The State's general obligations are rated Aaa by Moody's and AAA by Standard & Poors.

Limitations on Debt

The State Constitution authorizes general obligation long-term borrowing, with approval of the Legislature and a majority of the voters, and general obligation short-term notes, of which the principal may not exceed 15% of undedicated revenues received in the preceding year. No short-term borrowing occurred in fiscal year 2001-2002.

ECONOMIC CONDITION AND OUTLOOK

Michigan's economy was slowed by the U.S. recession and sluggish recovery. Michigan wage and salary employment fell by about 60,000 in fiscal year 2001-2002, a 1.3 percent decline. Michigan's unemployment rate averaged 6.2 percent. Michigan personal income fell in early fiscal year 2001-2002 before rising over the second half. For the fiscal year as a whole, income was flat. Weak wage and salary income growth was reflected in fiscal year 2001-2002 income tax withholding. Slow calendar year 2001 personal income growth, coupled with sharp declines in the stock markets, sharply reduced fiscal year 2001-2002 quarterly and annual income tax payments in April 2002.

In November 2002, the Research Seminar in Quantitative Economics (RSQE) at the University of Michigan released its forecasts for the U.S. and Michigan economies through calendar year 2004. According to RSQE's November 2002 forecast, Michigan personal income growth is projected to accelerate from 3.5 percent in calendar year 2003 to 5.3 percent in 2004. RSQE projects inflation, as measured by the Detroit consumer price index, to remain moderate at 2.7 percent and 2.4 percent, respectively in 2003 and 2004. RSQE projects Michigan wage and salary employment to fall 0.3 percent in 2003 before rising 1.8 percent in 2004.

CONTACTING THE STATE'S OFFICE OF FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Office of the State Budget, Office of Financial Management, Financial Reporting Section at (517) 373-3029.

The State's component units issue their own separately issued audited financial statements. These statements may be obtained by directly contacting the component unit. To obtain their phone numbers, you may contact the Office of Financial Management at (517) 373-3029.



BASIC FINANCIAL STATEMENTS

Michigan

STATEMENT OF NET ASSETS

SEPTEMBER 30, 2002

(In Thousands)

	PRIMARY GOVERNMENT			
	GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTALS	COMPONENT UNITS
ASSETS				
Current Assets:				
Cash	\$ 15,150	\$ 1,338	\$ 16,488	\$ 303,169
Equity in common cash (Note 5)	2,731,278	75,719	2,806,997	157,108
Taxes, interest, and penalties receivable (Note 6)	3,918,149	-	3,918,149	-
Internal balances	79,847	(79,847)	-	-
Amounts due from component units	35,887	294	36,181	5,262
Amounts due from primary government	-	-	-	196,542
Amounts due from federal government	995,705	24,025	1,019,730	20,193
Amounts due from local units	240,108	21,064	261,172	850,290
Inventories	50,647	6,966	57,613	16,959
Investments (Note 8)	451,210	2,467,126	2,918,336	815,911
Securities lending collateral (Note 8)	36,079	198,980	235,059	-
Other current assets	459,928	198,965	658,893	343,038
Total Current Assets	9,013,987	2,914,630	11,928,618	2,708,472
Restricted assets:				
Cash and cash equivalents	-	-	-	290,977
Investments	-	-	-	1,169,951
Mortgages and loans receivable	-	-	-	7,223
Taxes, interest, and penalties receivable (Note 8)	308,530	-	308,530	-
Amounts due from federal government	3,142	-	3,142	-
Amounts due from local units	628,629	-	628,629	1,849,412
Mortgages and loans receivable	-	-	-	2,788,830
Investments (Note 8)	442,199	673,943	1,116,142	2,002,557
Capital Assets (Note 9):				
Land and other non-depreciable assets	3,087,531	-	3,087,531	81,382
Buildings, equipment, and other depreciable assets	4,348,389	3,727	4,352,116	3,362,075
Less accumulated depreciation	(1,788,091)	(3,284)	(1,791,375)	(1,327,015)
Infrastructure	11,487,478	-	11,487,478	165,570
Construction in progress	1,214,590	-	1,214,590	284,590
Total capital assets	18,349,897	443	18,350,340	2,566,602
Interest in joint ventures (Note 7)	32,461	-	32,461	-
Other noncurrent assets	29,983	10,016	40,000	253,051
Total Assets	\$ 28,808,829	\$ 3,599,032	\$ 32,407,862	\$ 13,637,074
LIABILITIES				
Current Liabilities:				
Warrants outstanding	\$ 114,031	\$ 8,438	\$ 122,470	\$ 665
Obligations under security lending	36,079	198,980	235,059	-
Accounts payable and other liabilities	2,608,566	222,409	2,830,975	331,935
Income tax refunds payable (Note 15)	652,825	-	652,825	-
Amounts due to component units	10,328	-	10,328	4,600
Amounts due to primary government	-	-	-	6,410
Bonds and notes payable (Notes 12 and 13)	478,396	-	478,396	1,207,101
Interest payable	100,416	-	100,416	85,008
Deferred revenue	46,546	74	46,620	68,760
Current portion of other long-term obligations (Note 14)	296,350	448	296,798	87,822
Total Current Liabilities	4,343,538	430,349	4,773,887	1,792,302
Prize awards payable (Note 14)	-	554,546	554,546	-
Deferred revenue	55,327	-	55,327	1,236
Bonds and notes payable (Notes 12 and 13)	5,462,261	-	5,462,261	6,000,767
Noncurrent portion of other long-term obligations (Note 14)	1,577,747	45,344	1,623,091	1,428,297
Total Liabilities	\$ 11,438,873	\$ 1,030,240	\$ 12,469,112	\$ 9,222,603

The accompanying notes are an integral part of the financial statements.

Michigan

	PRIMARY GOVERNMENT			COMPONENT UNITS
	GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTALS	
NET ASSETS				
Invested in capital assets, net of related debt	\$ 15,014,812	\$ 443	\$ 15,015,255	\$ 1,680,918
Restricted For:				
Education	43,966	-	43,966	151,535
Construction and debt service	5,937	-	5,937	266,794
Public safety and corrections	19,334	-	19,334	-
Conservation, environment, recreation, and agriculture	393,335	-	393,335	-
Health services	23,718	-	23,718	-
Transportation	608,731	-	608,731	-
Intergovernmental-revenue sharing	189,321	-	189,321	-
Unemployment compensation	-	2,435,856	2,435,856	-
Other purposes	241,835	128,061	369,896	1,335,834
Funds Held as Permanent Investments:				
Expendable	74,683	-	74,683	-
Nonexpendable	415,710	-	415,710	-
Unrestricted	338,575	4,433	343,008	979,391
Total Net Assets	<u>\$ 17,369,957</u>	<u>\$ 2,568,793</u>	<u>\$ 19,938,749</u>	<u>\$ 4,414,471</u>

Michigan

STATEMENT OF ACTIVITIES

FISCAL YEAR ENDED SEPTEMBER 30, 2002

(In Thousands)

Functions/Programs	EXPENSES	PROGRAM REVENUES		
		CHARGES FOR SERVICES	OPERATING GRANTS AND CONTRIBUTIONS	CAPITAL GRANTS AND CONTRIBUTIONS
Primary Government:				
Governmental Activities:				
General government	\$ 1,560,139	\$ 664,533	\$ 43,891	\$ 2,908
Education	14,696,060	10,587	1,053,654	-
Family independence services	3,792,086	54,982	2,584,279	-
Public safety and corrections	2,161,486	113,058	102,536	-
Conservation, environment, recreation, and agriculture	691,796	233,430	111,702	1,146
Labor, commerce, and regulatory	898,235	256,314	524,099	-
Health services	8,952,390	56,822	6,018,687	-
Transportation	3,268,241	219,129	409,823	585,477
Tax expenditures (Note 15)	615,100	-	-	-
Intergovernmental-revenue sharing	1,517,303	-	-	-
Interest on long-term debt	248,263	-	-	-
Total governmental activities	38,401,099	1,608,855	10,848,672	589,530
Business-type Activities:				
Liquor Purchase Revolving Fund	494,696	607,413	-	-
State Lottery Fund	1,153,280	1,729,938	82,284	-
Michigan Unemployment Compensation Funds	2,328,713	1,426,748	453,241	-
Total business-type activities	3,976,689	3,764,099	535,524	-
Total primary government	\$ 42,377,787	\$ 5,372,954	\$ 11,384,196	\$ 589,530
Component Units:				
Authorities:				
Michigan Education Trust	\$ 81,279	\$ 319	\$ 48,898	\$ -
Michigan State Housing Development Authority	352,970	159,307	221,322	-
Michigan Municipal Bond Authority	162,008	101,780	134,261	-
Non-Major	558,052	110,624	297,810	-
State Universities:				
Central Michigan University	262,381	156,721	25,777	1,128
Western Michigan University	404,673	223,272	27,202	2,441
Non-Major	1,150,011	605,470	129,958	30,055
Total component units	\$ 2,971,375	\$ 1,357,493	\$ 885,229	\$ 33,623

General Revenues:

Taxes:

General:

Sales and use
Personal income
Single business
Other

Restricted For Educational Purposes:

Sales and use
Personal income
Education, property, and real estate transfers
Other

Restricted For Transportation Purposes:

Sales and use
Gasoline and diesel fuel
Motor vehicle weight
Other

Unrestricted investment and interest earnings

Miscellaneous

Contributions to permanent fund principal

Payments from State of Michigan

Special items

Transfers

Total general and other revenue, payments, and transfers

Change in net assets

Net assets-beginning-restated

Net assets-ending

The accompanying notes are an integral part of the financial statements.

Michigan

NET (EXPENSE) REVENUES AND CHANGES IN NET ASSETS			
PRIMARY GOVERNMENT			
GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTALS	COMPONENT UNITS
\$ (848,807)	\$ -	\$ (848,807)	\$ -
(13,631,819)	-	(13,631,819)	-
(1,152,825)	-	(1,152,825)	-
(1,945,892)	-	(1,945,892)	-
(345,518)	-	(345,518)	-
(117,822)	-	(117,822)	-
(2,876,881)	-	(2,876,881)	-
(2,053,812)	-	(2,053,812)	-
(615,100)	-	(615,100)	-
(1,517,303)	-	(1,517,303)	-
(248,263)	-	(248,263)	-
(25,354,041)	-	(25,354,041)	-
-	112,717	112,717	-
-	658,942	658,942	-
-	(448,724)	(448,724)	-
-	322,935	322,935	-
(25,354,041)	322,935	(25,031,106)	-
-	-	-	(32,063)
-	-	-	27,659
-	-	-	74,033
-	-	-	(149,618)
-	-	-	(78,755)
-	-	-	(151,759)
-	-	-	(384,528)
-	-	-	(695,030)
2,560,816	-	2,560,816	-
4,549,592	-	4,549,592	-
1,783,582	-	1,783,582	-
1,205,529	10,707	1,216,236	-
5,177,407	-	5,177,407	-
1,761,334	-	1,761,334	-
1,847,603	-	1,847,603	-
694,690	-	694,690	-
77,676	-	77,676	-
1,090,866	-	1,090,866	-
827,347	-	827,347	-
6,727	-	6,727	-
51,657	1,562	53,219	8,051
790,940	8	790,948	47,239
19,928	-	19,928	-
-	-	-	778,280
-	-	-	(5,000)
894,513	(894,513)	-	-
23,340,208	(882,235)	22,457,973	828,569
(2,013,834)	(559,300)	(2,573,134)	133,539
19,383,790	3,128,093	22,511,883	4,280,932
\$ 17,369,957	\$ 2,568,793	\$ 19,938,749	\$ 4,414,471



GOVERNMENTAL FUND FINANCIAL STATEMENTS



Major Funds

GENERAL FUND

This fund is the State's operating fund. It accounts for the financial resources and transactions not accounted for in other funds.

COUNTER - CYCLICAL BUDGET AND ECONOMIC STABILIZATION FUND

This fund, commonly referred to as the "Budget Stabilization Fund" or "Rainy Day Fund," was created by P.A. 76 of 1977 to assist in stabilizing revenue and employment during periods of economic recession and high unemployment. In general, transfers are made into this fund from the General Fund during improving economic times and funds flow from this fund to the General Fund in times of declining economy. Additional information regarding the fund is provided in Note 3.

SCHOOL AID FUND

An amendment to the 1908 State Constitution created this fund in 1955. The 1963 State Constitution provided for the fund's continued existence. Its purpose is to aid in the support of the public schools and the intermediate school districts of the State. School aid payments to school districts are based on a statutory formula.

The fund receives State revenues restricted to local school programs, including: the constitutionally dedicated sixty percent of the collections of sales tax imposed at a rate of 4% and all of the collections of sales tax imposed at the additional rate of 2%; State Lottery Fund earnings; a percentage of the adjusted gross receipts from casino gaming; the real estate transfer tax; and portions of the personal income, cigarette, liquor, and industrial and commercial facilities taxes. A constitutional amendment approved by voters in 1994 made structural changes in the method of financing local school districts. The amendment authorized the levy of a statewide property tax, which is deposited in the School Aid Fund. Appropriated transfers are also made from the General Fund.

Non-Major Funds

Non-major governmental funds are presented, by fund type, beginning on page 92.

Michigan

BALANCE SHEET
GOVERNMENTAL FUNDS
 SEPTEMBER 30, 2002
 (In Thousands)

	GENERAL FUND	COUNTER - CYCLICAL BUDGET AND ECONOMIC STABILIZATION FUND	SCHOOL AID FUND	NON-MAJOR FUNDS	TOTALS SEPTEMBER 30, 2002
ASSETS					
Current Assets:					
Cash	\$ 7,572	\$ -	\$ -	\$ 7,413	\$ 14,985
Equity in common cash (Note 5)	461,082	145,150	-	1,991,508	2,597,741
Taxes, interest, and penalties receivable (Note 6)	2,609,974	-	1,179,202	128,973	3,918,149
Amounts due from other funds (Note 17)	782,578	-	23,530	256,671	1,062,779
Amounts due from component units	647	-	-	35,240	35,887
Amounts due from federal agencies	789,885	-	1,606	204,214	995,705
Amounts due from local units	105,006	-	60,703	74,400	240,108
Inventories	24,360	-	-	8,334	32,695
Investments (Note 8)	-	-	-	451,210	451,210
Securities lending collateral	-	-	-	36,079	36,079
Other current assets	304,474	-	341	42,393	347,209
Total Current Assets	5,085,577	145,150	1,265,382	3,236,436	9,732,546
Taxes, interest, and penalties receivable (Note 6)	253,915	-	49,972	4,643	308,530
Advances to other funds (Note 17)	6,210	-	-	27,734	33,944
Amounts due from federal agencies	3,142	-	-	-	3,142
Amounts due from local units	583,266	-	652	44,711	628,629
Investments (Note 8)	-	-	-	442,199	442,199
Other noncurrent assets	3,714	-	-	7,222	10,936
Total Assets	\$ 5,935,825	\$ 145,150	\$ 1,316,007	\$ 3,762,944	\$ 11,159,927
LIABILITIES AND FUND BALANCES					
Current Liabilities:					
Warrants outstanding	\$ 91,066	\$ -	\$ 11	\$ 19,324	\$ 110,401
Obligations under security lending	-	-	-	36,079	36,079
Accounts payable and other liabilities (Note 22)	1,551,426	-	90,887	927,125	2,569,438
Income tax refunds payable (Note 15)	652,825	-	-	-	652,825
Amounts due to other funds (Note 17)	17,225	-	614,577	368,273	1,000,075
Amounts due to component units	10,228	-	-	100	10,328
Interest payable	-	-	-	333	333
Deferred revenue	1,447,008	-	318,625	49,519	1,815,152
Total Current Liabilities	3,769,778	-	1,024,100	1,400,753	6,194,631
Long-Term Liabilities:					
Advances from other funds (Note 17)	-	-	-	27,734	27,734
Deferred revenue	388,968	-	49,972	22,496	461,437
Total Liabilities	4,158,746	-	1,074,072	1,450,984	6,683,802
Fund Balances:					
Reserved fund balance (Note 21)	1,662,579	-	4,924	1,436,835	3,104,339
Unreserved fund balance reported in:					
General fund	114,500	-	-	-	114,500
Special revenue funds	-	145,150	237,010	586,540	968,700
Debt service funds	-	-	-	406,903	406,903
Capital projects funds	-	-	-	(158,776)	(158,776)
Permanent funds	-	-	-	40,459	40,459
Total Fund Balances	1,777,079	145,150	241,934	2,311,961	4,476,125
Total Liabilities and Fund Balances	\$ 5,935,825	\$ 145,150	\$ 1,316,007	\$ 3,762,944	\$ 11,159,927

The accompanying notes are an integral part of the financial statements.

**RECONCILIATION OF THE BALANCE SHEET - GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET ASSETS**

SEPTEMBER 30, 2002

(In Thousands)

Total fund balances for governmental funds		\$ 4,476,125
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. (Note 9)		
Land and other non-depreciable assets	3,087,531	
Buildings, equipment, and other depreciable assets	3,964,174	
Infrastructure	11,487,478	
Construction in progress	1,214,590	
Interest in joint ventures	32,461	
Accumulated depreciation	<u>(1,544,995)</u>	18,241,239
Certain tax revenues are earned but not available and therefore are not reported in the funds.		2,071,408
Other long-term assets are not available to pay for current period expenditures and therefore are deferred in the funds.		106,742
Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets.		136,917
Certain pension trust funds have been funded in excess of the annual required contributions, creating a year-end asset. This asset is not a current available resource and is not reported in the funds. (Note 10)		2,088
Deferred issue costs are reported as current expenditures in the funds. However, deferred issue costs are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets.		15,947
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds. (Note 14)		
Capital lease obligations	(428,084)	
Compensated absences	(396,149)	
Workers' compensation	(208,795)	
Litigation	(572,376)	
Net pension obligations	(30,201)	
Arbitrage	<u>(4,165)</u>	(1,639,770)
Long-term bonded debt is not due and payable in the current period and therefore is not reported in the funds. Unamortized premiums, loss on refundings, and interest payable are not reported in the funds. However, these amounts are included in the Statement of Net Assets. This is the net effect of these balances on the statement. (Note 12)		
Bonds and notes payable	(5,882,728)	
Unamortized premiums	(104,021)	
Less deferred loss amount on refundings	46,091	
Accrued interest payable	<u>(100,083)</u>	(6,040,740)
Net assets of governmental activities		<u><u>\$ 17,369,957</u></u>

The accompanying notes are an integral part of the financial statements.

Michigan

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

	GENERAL	COUNTER - CYCLICAL BUDGET AND ECONOMIC STABILIZATION FUND	SCHOOL AID FUND	NON-MAJOR FUNDS	TOTALS SEPTEMBER 30, 2002
REVENUES					
Taxes	\$ 10,493,581	\$ -	\$ 9,520,335	\$ 2,056,493	\$ 22,070,408
From federal agencies	8,951,725	-	183,019	1,068,973	10,203,716
From local agencies	115,593	-	-	133,273	248,867
From services	121,005	-	-	844	121,849
From licenses and permits	233,360	-	-	175,386	408,746
Special Medicaid reimbursements	1,109,233	-	-	-	1,109,233
Miscellaneous	504,952	20,794	14,709	677,933	1,218,388
Total Revenues	21,529,450	20,794	9,718,063	4,112,901	35,381,208
EXPENDITURES					
Current:					
General government	1,394,497	-	-	149,558	1,544,055
Education	3,046,570	-	11,371,034	327,111	14,744,715
Family independence services	3,791,373	-	-	2,601	3,793,974
Public safety and corrections	2,131,604	-	-	4,903	2,136,506
Conservation, environment, recreation, and agriculture	366,453	-	-	283,900	650,353
Labor, commerce, and regulatory	683,857	-	-	207,960	891,817
Health services	8,809,313	-	-	82,167	8,891,480
Transportation	-	-	-	2,118,452	2,118,452
Tax expenditures (Note 15)	615,100	-	-	-	615,100
Capital outlay	60,462	-	-	1,405,338	1,465,800
Intergovernmental-revenue sharing	1,517,303	-	-	-	1,517,303
Debt service:					
Bond principal retirement	-	-	-	226,801	226,801
Bond interest and fiscal charges	-	-	-	225,678	225,678
Capital lease payments	50,315	-	-	1,072	51,387
Total Expenditures	22,466,848	-	11,371,034	5,035,541	38,873,422
Excess of Revenues over (under) Expenditures	(937,398)	20,794	(1,652,971)	(922,639)	(3,492,214)
OTHER FINANCING SOURCES (USES)					
Bonds and notes issued	-	-	-	987,850	987,850
Premium on bond issuance	-	-	-	64,238	64,238
Refunding bonds issued	-	-	-	488,145	488,145
Payment to refunded bond escrow agent	-	-	-	(527,303)	(527,303)
Extinguishment of commercial paper	-	-	-	(51,890)	(51,890)
Capital lease acquisitions	234,468	-	-	2,804	237,272
Transfers from other funds	1,153,096	-	1,193,621	1,786,280	4,132,997
Transfers to other funds	(581,611)	(869,831)	(2,829)	(1,744,624)	(3,198,895)
Total Other Financing Sources (Uses)	805,953	(869,831)	1,190,792	1,005,500	2,132,415
Excess of Revenues and Other Sources over (under) Expenditures and Other Uses	(131,445)	(849,037)	(462,179)	82,861	(1,359,800)
Fund Balances - Beginning of fiscal year	1,908,525	994,187	704,113	2,229,100	5,835,924
Fund Balances - End of fiscal year	\$ 1,777,079	\$ 145,150	\$ 241,934	\$ 2,311,961	\$ 4,476,125

The accompanying notes are an integral part of the financial statements.

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**
SEPTEMBER 30, 2002
(In Thousands)

Net change in fund balance - total governmental funds \$ (1,359,800)

Governmental funds report capital outlay as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.
(Note 9)

Land and other non-depreciable assets	(6,202)	
Buildings, equipment, and other depreciable assets	316,094	
Gain on disposal - depreciable assets	5,104	
Infrastructure additions	144,666	
Infrastructure removed from service	(252,078)	
Construction in progress	274,251	
Accumulated depreciation	<u>(133,173)</u>	348,663

Certain revenues that were reported as resources in the funds but were earned in prior fiscal years are not reported in the Statement of Activities. (62,364)

Increase in equity interest in joint ventures (Note 7) 7,461

Tax revenues that were reported as resources in the funds but were earned in prior fiscal years are not reported in the Statement of Activities. (474,840)

Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities. 18,632

Bond proceeds provide current financial resources to governmental funds by issuing debt which increases long-term bonded debt in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term bonded debt in the Statement of Net Assets. This is the amount proceeds exceed repayments. (Note 12)

Bond proceeds and premiums received	(1,540,233)	
Repayment of bond principal	226,801	
Payment to refunded bond escrow agent	527,303	
Extinguishment of commercial paper	51,890	
Accrued interest and amortization	(17,904)	
Deferred issue costs	<u>7,800</u>	(744,344)

Certain expenditures are reported in the funds. However, they either increase or decrease long-term liabilities reported on the Statement of Net Assets and have been eliminated from the Statement of Activities.
(Note 14)

Net pension obligation	(112,456)	
Capital lease payments	21,713	
Compensated absences payments	35,719	
Litigation settlements and payments	315,474	
Workers' compensation	(8,944)	
Other	<u>1,251</u>	252,758

Change in net assets of governmental activities \$ (2,013,834)

The accompanying notes are an integral part of the financial statements.



PROPRIETARY FUND FINANCIAL STATEMENTS



Major Funds

STATE LOTTERY FUND

Public Act 239 of 1972 established the State Lottery Fund and created a Bureau of State Lottery under authority of Article 5, Section 4, of the State Constitution. This authority expired on August 1, 1974, at which time the Bureau became an organizational entity in the Department of Management and Budget. The Bureau was transferred to the Department of Treasury during fiscal year 1990-91. Net income of the fund related to lottery operations is transferred to the School Aid Fund and the fund's net income related to bingo and charity games regulation is transferred to the General Fund. The remaining net assets balance represents the unrealized cumulative gain or loss on investments, as required by GASB Statement No. 31.

Revenues and related expenses are recognized in the period during which the related drawings are held. Deferred prize awards are recorded as expenses and liabilities at their discounted present value. The State Treasurer invests funds equivalent to the discounted value of the installment payments and the Lottery Fund is credited with the interest earnings.

MICHIGAN UNEMPLOYMENT COMPENSATION FUNDS

The columns for the Michigan Unemployment Compensation Funds reflect the activity of two funds administered by the Bureau of Worker's and Unemployment Compensation within the Department of Consumer and Industry Services: the Michigan Unemployment Compensation Fund and the Michigan Employment Security Act Contingent Fund. The Michigan Unemployment Compensation Fund receives contributions from employers and provides for the payment of benefits to eligible unemployed workers. The fund also makes payments under certain federally funded programs. Administrative costs of the fund are accounted for in the Michigan Employment Security Act - Administration Fund, a special revenue fund.

The Michigan Employment Security Act Contingent Fund was created by P.A. 535 of 1982 to receive a special temporary unemployment tax surcharge, known as the solvency tax. The fund also receives interest and penalty charges on late contributions. Public Act 224 of 1989 restricts use of solvency taxes for payment of interest on the Michigan Unemployment Compensation borrowings from the federal government.

Non-Major Funds

LIQUOR PURCHASE REVOLVING FUND

Public Act 259 of 1941 authorized the creation of the Liquor Purchase Revolving Fund. The Liquor Control Commission, within the Department of Consumer and Industry Services, is primarily responsible for the fund. Under State monopoly, liquor is sold at wholesale through a State controlled, privately operated distribution system. The fund accounts for the sales of and the replenishing and transporting of the liquor stock. Administrative, warehousing, and delivery costs are paid for through the fund. At the end of each fiscal year, the "net income" of the fund is transferred to the General Fund in accordance with P.A. 431 of 1984.

Individual fund statements for the Internal Service Funds, whose combined totals are presented on this statement, begin on page 156.

Michigan

STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
 SEPTEMBER 30, 2002
 (In Thousands)

	BUSINESS-TYPE ACTIVITIES -- ENTERPRISE FUNDS				
	MAJOR		NON-MAJOR		
	STATE LOTTERY FUND	MICHIGAN UNEMPLOYMENT COMPENSATION FUNDS	LIQUOR PURCHASE REVOLVING FUND	TOTALS SEPTEMBER 30, 2002	GOVERNMENTAL ACTIVITIES -- INTERNAL SERVICE FUNDS
ASSETS					
Current Assets:					
Cash	\$ 2	\$ 1,336	\$ 1	\$ 1,338	\$ 165
Equity in common cash (Note 5)	6,484	17,672	51,563	75,719	133,537
Amounts due from other funds (Note 17)	-	8,182	-	8,182	49,653
Amounts due from component units	-	294	-	294	-
Amounts due from federal agencies	-	24,025	-	24,025	-
Amounts due from local units	-	21,064	-	21,064	-
Inventories	3,572	-	3,394	6,966	17,953
Investments (Note 8)	109,384	2,357,742	-	2,467,126	-
Securities lending collateral	198,980	-	-	198,980	-
Other current assets	54,835	138,804	5,326	198,965	112,309
Total Current Assets	373,257	2,569,120	60,283	3,002,659	313,617
Investments (Note 8)	673,943	-	-	673,943	-
Capital Assets (Note 9):					
Buildings and equipment	3,727	-	-	3,727	384,214
Allowance for depreciation	(3,284)	-	-	(3,284)	(243,096)
Total capital assets	443	-	-	443	141,119
Other noncurrent assets	-	10,016	-	10,016	955
Total Assets	\$ 1,047,643	\$ 2,579,136	\$ 60,283	\$ 3,687,061	\$ 455,692
LIABILITIES					
Current Liabilities:					
Warrants outstanding	\$ 1,685	\$ -	\$ 6,753	\$ 8,438	\$ 3,630
Accounts payable and other liabilities (Note 22)	139,120	35,193	48,096	222,409	23,242
Amounts due to other funds (Note 17)	23,581	64,393	54	88,029	48,123
Deferred revenue	-	74	-	74	3,242
Obligations under security lending (Note 8)	198,980	-	-	198,980	-
Current portion of other long-term obligations (Note 14)	123	-	325	448	119,641
Total Current Liabilities	363,489	99,660	55,229	518,378	197,878
Long-Term Liabilities:					
Advances from other funds (Note 17)	-	-	-	-	6,210
Prize awards payable	554,546	-	-	554,546	-
Noncurrent portion of other long-term obligations (Note 14)	1,546	43,619	178	45,344	114,686
Total Liabilities	919,582	143,280	55,407	1,118,269	318,774
NET ASSETS					
Invested in capital assets, net of related debt	\$ 443	\$ -	\$ -	\$ 443	\$ 107,825
Restricted For:					
Unemployment compensation	-	2,435,856	-	2,435,856	-
Other purposes	128,061	-	-	128,061	8,899
Unrestricted	(443)	-	4,876	4,433	20,193
Total Net Assets	\$ 128,061	\$ 2,435,856	\$ 4,876	\$ 2,568,793	\$ 136,917

The accompanying notes are an integral part of the financial statements.

Michigan

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

BUSINESS-TYPE ACTIVITIES -- ENTERPRISE FUNDS					
	MAJOR		NON-MAJOR		
	STATE LOTTERY FUND	MICHIGAN UNEMPLOYMENT COMPENSATION FUNDS	LIQUOR PURCHASE REVOLVING FUND	TOTALS SEPTEMBER 30, 2002	GOVERNMENTAL ACTIVITIES -- INTERNAL SERVICE FUNDS
OPERATING REVENUES					
Operating revenues	\$ 1,729,938	\$ 1,426,748	\$ 607,413	\$ 3,764,099	\$ 1,567,464
Total Operating Revenues	1,729,938	1,426,748	607,413	3,764,099	1,567,464
OPERATING EXPENSES					
Salaries, wages, and other administrative	204,686	-	49,066	253,752	650,263
Depreciation	158	-	-	158	44,682
Purchases for resale	-	-	443,885	443,885	41,094
Purchases for prison industries	-	-	-	-	16,690
Lottery prize awards	894,955	-	-	894,955	-
Premiums and claims	-	-	1	1	761,479
Unemployment benefits	-	1,926,001	-	1,926,001	-
Other operating expenses	-	402,712	1,743	404,455	64,731
Total Operating Expenses	1,099,798	2,328,713	494,696	3,923,206	1,578,940
Operating Income (Loss)	630,140	(901,965)	112,717	(159,107)	(11,477)
NONOPERATING REVENUES (EXPENSES)					
Specific tax on spirits	-	-	10,707	10,707	-
Interest revenue	1,621	-	1,562	3,182	-
Investment revenue (expense) - net	80,663	157,417	-	238,080	-
Other nonoperating revenues	-	295,823	-	295,823	9,268
Amortization of prize award obligation discount	(48,726)	-	-	(48,726)	-
Interest expense	(4,756)	-	-	(4,756)	(1,657)
Other nonoperating expense	-	-	8	8	(393)
Total Nonoperating Revenues (Expenses)	28,802	453,241	12,278	494,320	7,218
Income (Loss) Before Capital Contributions and Transfers	658,942	(448,724)	124,995	335,212	(4,259)
CAPITAL CONTRIBUTIONS AND TRANSFERS					
Capital contributions from other funds	-	-	-	-	23,561
Transfers from other funds	-	3,674	-	3,674	-
Transfers To:					
School Aid Fund	(613,530)	-	-	(613,530)	-
Other funds	(13,056)	(144,806)	(126,795)	(284,657)	(670)
Total transfers to other funds	(626,586)	(144,806)	(126,795)	(898,187)	(670)
Total Capital Contributions and Transfers In (Out)	(626,586)	(141,132)	(126,795)	(894,513)	22,891
Change in net assets	32,355	(589,856)	(1,800)	(559,300)	18,632
Total net assets - Beginning of fiscal year	95,706	3,025,712	6,676	3,128,093	118,286
Total net assets - End of fiscal year	\$ 128,061	\$ 2,435,856	\$ 4,876	\$ 2,568,793	\$ 136,917

The accompanying notes are an integral part of the financial statements.

Michigan

STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

	BUSINESS-TYPE ACTIVITIES -- ENTERPRISE FUNDS				GOVERNMENTAL ACTIVITIES -- INTERNAL SERVICE FUNDS
	MAJOR		NON-MAJOR	TOTALS	
	STATE LOTTERY FUND	MICHIGAN UNEMPLOYMENT COMPENSATION FUNDS	LIQUOR PURCHASE REVOLVING FUND	SEPTEMBER 30, 2002	
CASH FLOWS FROM OPERATING ACTIVITIES					
Receipts from federal and local agencies	\$ -	\$ 379,009	\$ -	\$ 379,009	\$ -
Receipts from customers	1,704,354	1,017,074	607,413	3,328,841	1,109,099
Payments to employees	(12,803)	-	(14,209)	(27,012)	(51,106)
Payments to suppliers	(39,578)	-	(484,879)	(524,457)	(445,028)
Payments to prize winners	(1,002,860)	-	-	(1,002,860)	-
Payments for commissions to retailers	(150,203)	-	-	(150,203)	-
Claims paid	-	(2,313,706)	-	(2,313,706)	(568,860)
Other receipts	-	1,641	8	1,649	489
Other payments	-	-	(1,249)	(1,249)	(16,631)
Net cash provided (used) by operating activities	\$ 498,910	\$ (915,982)	\$ 107,084	\$ (309,989)	\$ 27,963
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES					
Other nonoperating revenues	\$ -	\$ 295,823	\$ -	\$ 295,823	\$ -
Loans or loan repayments from other funds	-	-	-	-	24,084
Loans or loan repayments to other funds	-	-	-	-	(25,005)
Specific tax on spirits	-	-	10,707	10,707	-
Transfers to other funds	(612,066)	(83,360)	(126,795)	(822,220)	(670)
Net cash provided (used) by noncapital financing activities	\$ (612,066)	\$ 212,463	\$ (116,087)	\$ (515,690)	\$ (1,592)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES					
Acquisition and construction of capital assets	\$ (313)	\$ -	\$ -	\$ (313)	\$ (28,702)
Interest paid	-	-	-	-	(299)
Capital lease payments (including imputed interest expense)	-	-	-	-	(15,857)
Proceeds from sale of capital assets	-	-	-	-	8,462
Net cash provided (used) by capital and related financing activities	\$ (313)	\$ -	\$ -	\$ (313)	\$ (36,396)
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of investment securities	\$ (40,879)	\$ -	\$ -	\$ (40,879)	\$ -
Proceeds from sale and maturities of investment securities	150,729	476,806	-	627,535	-
Interest and dividends on investments	1,621	157,417	1,562	160,599	9,224
Income from securities lending activities	5,653	-	-	5,653	-
Expenses from securities lending activities	(4,756)	-	-	(4,756)	-
Net cash provided (used) by investing activities	\$ 112,367	\$ 634,223	\$ 1,562	\$ 748,152	\$ 9,224
Net cash provided (used) - all activities	\$ (1,102)	\$ (69,296)	\$ (7,442)	\$ (77,839)	\$ (801)
Cash and cash equivalents at beginning of year	5,902	88,304	52,252	146,458	130,873
Cash and cash equivalents at end of year	<u>\$ 4,801</u>	<u>\$ 19,008</u>	<u>\$ 44,810</u>	<u>\$ 68,619</u>	<u>\$ 130,072</u>

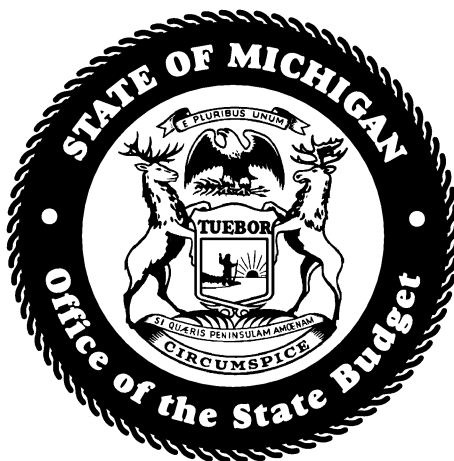
The accompanying notes are an integral part of the financial statements.

Michigan

	BUSINESS-TYPE ACTIVITIES -- ENTERPRISE FUNDS				
	MAJOR		NON-MAJOR	TOTALS	GOVERNMENTAL
	STATE LOTTERY FUND	MICHIGAN UNEMPLOYMENT COMPENSATION FUNDS	LIQUOR PURCHASE REVOLVING FUND	SEPTEMBER 30, 2002	ACTIVITIES -- INTERNAL SERVICE FUNDS
RECONCILIATION OF CASH AND CASH EQUIVALENTS					
Per Balance Sheet Classifications:					
Cash	\$ 2	\$ 1,336	\$ 1	\$ 1,338	\$ 165
Equity in common cash	6,484	17,672	51,563	75,719	133,537
Warrants outstanding	(1,685)	-	(6,753)	(8,438)	(3,630)
Cash and cash equivalents at end of year	<u>\$ 4,801</u>	<u>\$ 19,008</u>	<u>\$ 44,810</u>	<u>\$ 68,619</u>	<u>\$ 130,072</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES					
Operating income (loss)	\$ 630,140	\$ (901,965)	\$ 112,717	\$ (159,107)	\$ (11,477)
Adjustments to Reconcile Operating Income to Net Cash Provided (Used)					
by Operating Activities:					
Depreciation expense	158	-	-	158	44,682
Amortization of prize award obligation discount	(48,726)	-	-	(48,726)	-
Other reconciling items	171	-	-	171	(9,272)
Net Changes in Assets and Liabilities:					
Inventories	(1,441)	-	(102)	(1,543)	1,690
Other assets (net)	(4,470)	(33,504)	503	(37,471)	11,305
Accounts payable and other liabilities	3,510	19,635	(6,034)	17,110	(8,966)
Prize awards payable	(80,432)	-	-	(80,432)	-
Deferred revenue	-	(148)	-	(148)	-
Net cash provided (used) by operating activities	<u>\$ 498,910</u>	<u>\$ (915,982)</u>	<u>\$ 107,084</u>	<u>\$ (309,989)</u>	<u>\$ 27,963</u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES					
Cost of capital assets acquisitions					
financed by capital leases	\$ -	\$ -	\$ -	\$ -	\$ 18,989
Capital lease liabilities entered into during the year	-	-	-	-	(18,989)
Increase (decrease) in fair value of investments	24,496	-	-	24,496	-
Transfers from other funds	-	3,674	-	3,674	-
Transfers to other funds (accrual)	(23,530)	(61,446)	-	(84,976)	-
Gain (loss) on disposal of capital assets	-	-	-	-	(365)
Total noncash investing, capital, and financing activities	<u>\$ 966</u>	<u>\$ (57,772)</u>	<u>\$ -</u>	<u>\$ (56,806)</u>	<u>\$ (365)</u>



FIDUCIARY FUND FINANCIAL STATEMENTS



Individual fund descriptions and financial statements begin on the following pages:

Pension (and Other Employee Benefit) Trust Funds, page 164
Private Purpose Trust Funds, page 170
Agency Funds, page 175

STATEMENT OF FIDUCIARY NET ASSETS

FIDUCIARY FUNDS

SEPTEMBER 30, 2002

(In Thousands)

	PENSION (AND OTHER EMPLOYEE BENEFIT) TRUST FUNDS	PRIVATE PURPOSE TRUST FUNDS	AGENCY FUNDS
ASSETS			
Cash	\$ 1,151	\$ 635	\$ 32,885
Equity in common cash (Note 5)	134,626	53,561	5,720
Receivables:			
From participants	100,003	-	-
From employers	451,064	-	-
Interest and dividends	151,543	466	-
Due from other funds (Note 17)	15,936	-	-
Sale of investments	7,740	-	-
Investments at Fair Value (Note 8):			
Short term investments	894,022	-	18,894
Bonds, notes, mortgages, and preferred stock	9,351,662	13,950	83,782
Common stock	16,519,070	73	-
Real estate	3,927,982	-	-
Alternative investments	5,652,439	-	-
International investments	2,968,501	-	-
Mutual funds	1,237,743	172,417	-
Pooled investment funds	1,590,263	33,971	-
Money market funds	228,367	-	-
Securities lending collateral (Note 8)	1,744,533	-	-
Capital Assets:			
Buildings and equipment	24	-	-
Allowance for depreciation	(24)	-	-
Total capital assets	-	-	-
Other current assets	-	4,175	7,950
Other noncurrent assets	-	-	357,954
Total assets	\$ 44,976,645	\$ 279,247	\$ 507,186
LIABILITIES			
Warrants outstanding	\$ 11,906	\$ 1,929	\$ 119
Accounts payable and other liabilities	174,300	5,129	65,514
Amounts due to other funds (Note 17)	51	-	273
Obligations under security lending	1,744,533	-	-
Other long-term liabilities	-	-	441,280
Total liabilities	\$ 1,930,791	\$ 7,058	\$ 507,186
NET ASSETS			
Net assets held in trust for pension, postemployment health-care, other employee benefits, and other purposes	\$ 43,045,854	\$ 272,189	
Reconciliation of Net Assets Held in Trust:			
Pension benefits (Note 10)	\$ 39,874,694	\$ -	
Postemployment health-care benefits	421,414	-	
Other employee benefits (Note 16)	2,749,746	-	
Other purposes	-	272,189	
Total net assets held in trust for benefits and other purposes	\$ 43,045,854	\$ 272,189	

The accompanying notes are an integral part of the financial statements.

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FIDUCIARY FUNDS
FISCAL YEAR ENDED SEPTEMBER 30, 2002
(In Thousands)

	PENSION (AND OTHER EMPLOYEE BENEFIT) TRUST FUNDS	PRIVATE PURPOSE TRUST FUNDS
ADDITIONS		
Contributions:		
From participants	\$ 838,473	\$ 177,636
From employers	1,648,189	-
From clients	-	38,090
From gifts, bequests, and endowments	-	291
From other plans	3,047	-
Investment Income:		
Net appreciation (depreciation) in fair value of investments	(6,112,343)	(26,417)
Interest, dividends, and other	1,148,498	5,229
Securities lending income	45,413	5
Less Investment Expense:		
Investment activity expense	84,620	571
Securities lending expense	36,390	4
Net investment income (loss)	(5,039,443)	(21,758)
Escheated property	-	43,618
Miscellaneous income	2,097	601
Transfers from other funds	-	316
Total Additions	(2,547,637)	238,794
DEDUCTIONS		
Benefits paid to participants or beneficiaries	3,014,171	4,386
Medical, dental, and life insurance for retirees	821,835	-
Refunds and transfers to other systems	21,022	-
Amounts distributed to clients or third parties	-	39,221
Administrative expense	83,408	39
Transfers to other funds	97	39,138
Total Deductions	3,940,533	82,783
Net increase (decrease)	(6,488,170)	156,011
Net assets - Beginning of fiscal year	49,534,024	116,178
Net assets - End of fiscal year (Note 10)	\$ 43,045,854	\$ 272,189
Reconciliation of Net Increase in Assets:		
Net increase (decrease) in assets held in trust for pension benefits	\$ (6,331,854)	\$ -
Net increase (decrease) in assets held in trust for postemployment benefits	182,699	-
Net increase (decrease) in assets held in trust for other employee benefits	(339,015)	-
Net increase (decrease) in assets held in trust for other purposes	-	156,011
Total net increase (decrease)	\$ (6,488,170)	\$ 156,011

The accompanying notes are an integral part of the financial statements.



COMPONENT UNIT FINANCIAL STATEMENTS



Major Funds

MICHIGAN EDUCATION TRUST

The Michigan Education Trust (MET) operates a prepaid tuition program. A purchaser enters into a contract with MET which provides that in return for a specified actuarially determined payment, MET will provide a Michigan child's undergraduate tuition at any Michigan public university or community college. The amount the purchaser is required to pay is based on several factors, among them are tuition costs, the child's age and grade in school, anticipated investment earnings, tuition rate increases, and the type of contract purchased.

Public Act 316 of 1986 created MET. MET is governed by a nine-member board that consists of the State Treasurer and eight other individuals appointed by the Governor with the advice and consent of the Senate. Although MET is administratively located within the Michigan Department of Treasury, the Act provides its assets are not to be considered assets of the State and are not to be loaned or otherwise transferred or used by the State for any purpose other than the purposes specified in the Act. The Act and contracts also specifically provide that the State is not liable if MET becomes actuarially unsound. In that event, the contracts provide for refunds to participants.

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

Public Act 346 of 1966, as amended, created the Michigan State Housing Development Authority (MSHDA) to issue notes and bonds to finance housing for sale or rental to families with low or moderate incomes and to finance home improvements. MSHDA is also the administrator of various "Section 8" housing programs in Michigan for the U.S. Department of Housing and Urban Development. The Governor appoints MSHDA's board members.

MICHIGAN MUNICIPAL BOND AUTHORITY

Public Act 227 of 1985, as amended, created the Michigan Municipal Bond Authority (MMBA) to assist local units of government in reducing their financing costs for public improvements, deficit reduction, and various other municipal purposes. MMBA pools the borrowing needs of various units and issues limited obligation debt; the proceeds of which are used to purchase local unit obligations or to make loans to local units.

MMBA is governed by a board of trustees consisting of the State Treasurer, two appointees of the Governor, and five state residents appointed by the Governor, with the advice and consent of the Senate.

MMBA and the Department of Environmental Quality serve as co-administrators of a special State Revolving Fund, which is reported as part of MMBA. The State Revolving Fund assists governmental units in financing water quality projects. Federal government and State matching provides financing for this activity along with investment interest earnings and/or other available funds. MMBA's separately issued financial reports provide a separate accounting of this fund's activities.

CENTRAL MICHIGAN UNIVERSITY AND WESTERN MICHIGAN UNIVERSITY

Central Michigan University and Western Michigan University are the two major universities of the ten universities included in this report. They are legally separate entities whose governing boards are appointed by the Governor and for which the State is therefore, defined as legally accountable. Excluded from this report are three other universities (University of Michigan, Michigan State University and Wayne State University) whose board members are elected by the voters and, therefore, considered separate special purpose governments.

Non-Major Funds

The non-major component unit - authorities are presented beginning on page 180.

The non-major component unit - State universities are presented beginning on page 186.

STATEMENT OF NET ASSETS
COMPONENT UNITS
 SEPTEMBER 30, 2002
 (In Thousands)

	AUTHORITIES			
	MICHIGAN EDUCATION TRUST	MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY	MICHIGAN MUNICIPAL BOND AUTHORITY	NON-MAJOR
ASSETS				
Current Assets:				
Cash	\$ 76,094	\$ -	\$ -	\$ 43,724
Equity in common cash (Note 5)	-	-	11,378	145,729
Amounts due from component units	-	-	-	4,600
Amounts due from primary government	969	-	566	8,775
Amounts due from federal government	-	-	-	7,752
Amounts due from local units	-	-	850,183	-
Inventories	-	-	-	621
Investments (Note 8)	-	-	633,656	66,496
Other current assets	22,024	70,028	37,962	137,686
Total Current Assets	99,087	70,028	1,533,745	415,383
Restricted Assets:				
Cash and cash equivalents	-	151,586	-	77,292
Investments	-	614,240	-	555,710
Mortgages and loans receivable	-	-	-	-
Amounts due from local units	-	-	1,849,412	-
Mortgages and loans receivable	-	1,864,712	-	857,627
Investments (Note 8)	798,594	-	808,691	71,852
Capital Assets:				
Land and other non-depreciable assets	-	-	-	843
Buildings, equipment, and other depreciable assets	-	-	-	46,237
Less accumulated depreciation	-	-	-	(14,347)
Infrastructure	-	-	-	101,349
Construction in progress	-	-	-	20
Total capital assets	-	-	-	134,102
Other noncurrent assets	35,644	48,833	135,679	14,454
Total Assets	\$ 933,325	\$ 2,749,399	\$ 4,327,526	\$ 2,126,420
LIABILITIES				
Current Liabilities:				
Warrants outstanding	\$ -	\$ -	\$ -	\$ 665
Accounts payable and other liabilities	14,893	24,957	16,810	43,706
Amounts due to component units	-	-	-	4,600
Amounts due to primary government	-	-	823	1,006
Bonds and notes payable (Note 13)	-	180,735	823,334	177,355
Interest payable	-	14,543	47,140	7,237
Deferred revenue	-	-	13,605	2,827
Current portion of other long-term obligations	65,503	-	-	8,319
Total Current Liabilities	80,397	220,235	901,714	245,715
Deferred revenue	-	-	-	-
Bonds and notes payable (Note 13)	-	1,648,104	2,133,227	1,281,876
Noncurrent portion of other long-term obligations	782,221	445,734	80,580	53,534
Total Liabilities	\$ 862,618	\$ 2,314,073	\$ 3,115,520	\$ 1,581,125
NET ASSETS				
Invested in capital assets, net of related debt	\$ -	\$ -	\$ -	\$ 126,071
Restricted For:				
Education	-	-	-	-
Construction and debt service	-	201,747	-	13,979
Other purposes	70,707	-	1,204,482	21,548
Unrestricted	-	233,579	7,524	383,697
Total Net Assets	\$ 70,707	\$ 435,326	\$ 1,212,006	\$ 545,295

The accompanying notes are an integral part of the financial statements.

Michigan

STATE UNIVERSITIES

CENTRAL MICHIGAN UNIVERSITY	WESTERN MICHIGAN UNIVERSITY	NON-MAJOR	TOTALS
			SEPTEMBER 30, 2002
\$ 15,174	\$ 11,738	\$ 156,440	\$ 303,169
-	-	-	157,108
-	-	662	5,262
46,005	24,780	115,446	196,542
234	2,522	9,684	20,193
-	-	106	850,290
2,710	5,719	7,910	16,959
-	63,261	52,499	815,911
15,004	8,514	51,821	343,038
<u>79,128</u>	<u>116,534</u>	<u>394,566</u>	<u>2,708,472</u>
36,586	-	25,513	290,977
-	-	-	1,169,951
7,223	-	-	7,223
-	-	-	1,849,412
-	8,268	58,223	2,788,830
105,066	25,520	192,835	2,002,557
9,337	13,617	57,585	81,382
400,802	676,377	2,238,660	3,362,075
(182,605)	(275,065)	(854,998)	(1,327,015)
7,140	-	57,080	165,570
27,597	102,722	154,251	284,590
<u>262,271</u>	<u>517,652</u>	<u>1,652,577</u>	<u>2,566,602</u>
-	4,788	13,654	253,051
<u>\$ 490,273</u>	<u>\$ 672,761</u>	<u>\$ 2,337,368</u>	<u>\$ 13,637,074</u>
\$ -	\$ -	\$ -	\$ 665
43,575	70,014	117,979	331,935
-	-	-	4,600
225	24	4,331	6,410
3,550	5,321	16,806	1,207,101
1,398	11,216	3,474	85,008
8,046	10,259	34,023	68,760
-	-	13,999	87,822
<u>56,795</u>	<u>96,834</u>	<u>190,612</u>	<u>1,792,302</u>
-	-	1,236	1,236
132,487	247,016	558,057	6,000,767
15,140	13,734	37,354	1,428,297
<u>\$ 204,422</u>	<u>\$ 357,584</u>	<u>\$ 787,259</u>	<u>\$ 9,222,603</u>
\$ 162,685	\$ 245,791	\$ 1,146,372	\$ 1,680,918
28,501	10,222	112,812	151,535
6,106	5,582	39,379	266,794
-	8,955	30,141	1,335,834
88,560	44,627	221,405	979,391
<u>\$ 285,851</u>	<u>\$ 315,177</u>	<u>\$ 1,550,109</u>	<u>\$ 4,414,471</u>

STATEMENT OF ACTIVITIES

COMPONENT UNITS

FISCAL YEAR ENDED SEPTEMBER 30, 2002

(In Thousands)

FUNCTIONS/PROGRAMS	EXPENSES	PROGRAM REVENUES			
		CHARGES FOR SERVICES	OPERATING GRANTS/ CONTRIBUTIONS	CAPITAL GRANTS/ CONTRIBUTIONS	NET (EXPENSE) REVENUE
Authorities:					
Michigan Education Trust	\$ 81,279	\$ 319	\$ 48,898	\$ -	\$ (32,063)
Michigan State Housing Development Authority	352,970	159,307	221,322	-	27,659
Michigan Municipal Bond Authority	162,008	101,780	134,261	-	74,033
Non-Major	558,052	110,624	297,810	-	(149,618)
State Universities:					
Central Michigan University	262,381	156,721	25,777	1,128	(78,755)
Western Michigan University	404,673	223,272	27,202	2,441	(151,759)
Non-Major	1,150,011	605,470	129,958	30,055	(384,528)
Total	<u>\$ 2,971,375</u>	<u>\$ 1,357,493</u>	<u>\$ 885,229</u>	<u>\$ 33,623</u>	<u>\$ (695,030)</u>

The accompanying notes are an integral part of the financial statements.

Michigan

GENERAL REVENUES						
INTEREST AND INVESTMENT EARNINGS (LOSS)	PAYMENTS FROM STATE OF MICHIGAN	OTHER	SPECIAL ITEMS	CHANGE IN NET ASSETS	NET ASSETS BEGINNING OF YEAR RESTATE	NET ASSETS END OF YEAR
\$ -	\$ -	\$ -	\$ -	\$ (32,063)	\$ 102,770	\$ 70,707
-	-	-	-	27,659	407,667	435,326
-	-	-	(4,629)	69,404	1,142,602	1,212,006
694	105,003	16,301	(371)	(27,991)	573,286	545,295
(381)	102,596	110	-	23,570	262,281	285,851
4,068	127,167	18,711	-	(1,813)	316,990	315,177
3,670	443,514	12,118	-	74,774	1,475,335	1,550,109
<u>\$ 8,051</u>	<u>\$ 778,280</u>	<u>\$ 47,239</u>	<u>\$ (5,000)</u>	<u>\$ 133,539</u>	<u>\$ 4,280,932</u>	<u>\$ 4,414,471</u>

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the State conform in all material respects to generally accepted accounting principles (GAAP) as applicable to governments. The Governmental Accounting Standards Board (GASB) is the standard setting body for establishing governmental accounting and financial reporting principles, which are primarily set forth in the GASB's Codification of Governmental Accounting and Financial Reporting Standards (GASB Codification). Following is a summary of the significant policies:

A. Reporting Entity

Michigan was admitted to the Union as the twenty-sixth state in 1837. The State of Michigan is governed under the Constitution of 1963, as amended. The legislative power is vested in a 38-member senate and a 110-member house of representatives; executive power is vested in a governor; and the judicial power is vested exclusively in one court of justice.

For financial reporting purposes, the State of Michigan's reporting entity includes the "primary government" and its "component units." The primary government includes all funds, departments and agencies, bureaus, boards, commissions, and those authorities that are considered an integral part of the primary government. Component units are legally separate governmental organizations for which the State's elected officials are financially accountable.

Financial accountability is defined in GASB Statement No. 14, The Financial Reporting Entity. The State is financially accountable for those entities in which the State appoints a voting majority of an organization's governing authority, and either is able to impose its will upon the entity or there exists a financial benefit or burden relationship with the State. For those entities in which the State does not appoint a voting majority of the governing authority, GASB Statement No. 14 requires inclusion in the reporting entity if they are fiscally dependent on the State or if it would be misleading to exclude the authority.

Blended Component Units

The State Building Authority and the Michigan Underground Storage Tank Financial Assurance Finance Authority are legally separate organizations that have boards appointed by the primary government and provide services primarily to benefit the State. Therefore, they are reported as though they were part of the primary government, using the blending method.

Discretely Presented Component Units

These types of component units are reported in separate columns or rows in the government-wide statements to emphasize that they are legally separate from the government.

The State is able to impose its will upon these discretely presented component units:

The Michigan Education Trust offers contracts which, for actuarially determined amounts, provide plan participants with future tuition at institutions of higher education.

The Michigan State Housing Development Authority finances loans for the construction of single and multi-family housing and home improvement projects.

The Michigan Municipal Bond Authority assists local units by pooling their borrowing activities. This authority is also responsible for assisting local units with their financing of water pollution control projects.

The Michigan Higher Education Facilities Authority accounts for the administration of no-commitment debt issued for the benefit of private institutions of higher education.

The Mackinac Bridge Authority accounts for the operation of the Mackinac Bridge.

The Michigan Strategic Fund provides business enterprises with additional sources of financing.

The Michigan State Hospital Finance Authority accounts for the administration of limited obligation debt issued for the benefit of hospitals.

The Michigan Higher Education Student Loan Authority is a financing authority that makes loans to students or their parents.

The Michigan Higher Education Assistance Authority is the State guaranty agency under the Stafford Loan Program, the Supplemental Loans to Students Program, and the Parent Loan for Undergraduate Students Program. This Authority also administers scholarships and grants that are financed with General Fund appropriations.

The Michigan Broadband Development Authority is a financing authority that assists in the build-out of broadband infrastructure to accelerate the deployment of high-speed Internet connections Statewide.

The Michigan Public Educational Facilities Authority partners with other states to facilitate the acquisition of capital for the construction, rehabilitation, refurbishing, or equipping of qualified public educational facilities.

There is a financial burden/benefit relationship between these entities and the State:

The Mackinac Island State Park Commission operates the Mackinac Island and Michilimackinac State Parks.

The Michigan Economic Development Corporation manages programs to stimulate, coordinate, and advance economic development in the State.

The following entity's relationship with the State would be misleading if it were omitted from the State's reporting entity:

The State Bar of Michigan is a public body corporate whose membership consists of persons licensed to practice law.

Ten of the State's public universities are considered component units because they have boards appointed by the primary government. Their balances and operating results are included with the other discretely presented components units on the government-wide statements. The ten universities included in these statements are: Central Michigan University, Eastern Michigan University, Ferris State University, Grand Valley State University, Lake Superior State University, Michigan Technological University, Northern Michigan University, Oakland University, Saginaw Valley State University, and Western Michigan University. Michigan State University, the University of Michigan, and Wayne State University are not included in the State's reporting entity because they have separately elected governing boards and are legally separate. The State provides significant funding to support these institutions; however, under GASB Statement No. 14 criteria, they are considered fiscally independent, special-purpose governments.

Availability of Financial Statements

The State's component units issue their own separately issued audited financial statements. These statements may be obtained by directly contacting the various component units. To obtain their phone numbers, you may contact the Office of the State Budget, Office of Financial Management, Financial Reporting Section at (517) 373-3029.

Related Organizations

The State's Insurance Commissioner is responsible for appointing the members of the boards of the Michigan Catastrophic Claims Association and the Michigan Property and Casualty Guaranty Association, but the State's accountability for these organizations does not extend beyond making the appointments.

Joint Ventures

As discussed in more detail in Note 7, the State participates in two joint ventures. Its financial activities are not included in the State's fund financial statements, but the State's equity interest is recorded as an asset in the Statement of Net Assets.

Jointly Governed Organizations

The State, the University of Michigan, Michigan State University, and Wayne State University appoint members of the board of the Michigan Public Health Institute (MPHI), a non-profit corporation. MPHI was established to plan, promote, and coordinate health services research with a public university or a consortium of public universities in the State. The State does not appoint a majority of the board, has no rights to the assets, and is not responsible for debts of MPHI. Therefore, the State's accountability for MPHI does not extend beyond making the appointments. During fiscal year 2001-2002, the State awarded contracts totaling \$25.4 million to MPHI.

B. Government-Wide and Fund Financial Statements

Government-Wide Financial Statements

The Statement of Net Assets and Statement of Activities report information on all non-fiduciary activities of the primary government and its component units. Primary government activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

The **Statement of Net Assets** presents the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

The **Statement of Activities** demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are instead reported as general revenue.

Fund Financial Statements

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide statements. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Measurement Focus and Basis of Accounting

The government-wide statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

As allowed by GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, the State's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

Governmental fund statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become *susceptible to accrual*; generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State generally considers tax revenues and court settlements to be available if they are collected within 60 days of the end of the fiscal period. Revenues that the State earns by incurring obligations are recognized in the same period as when the obligations are recognized.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to debt service, compensated absences, and claims and judgments, are recorded only when payment is due and payable.

Financial Statement Presentation

The State reports the following major governmental funds:

The General Fund is the State's primary operating fund. It accounts for all financial resources except those required to be accounted for in another fund.

The Counter-Cyclical Budget and Economic Stabilization Fund, commonly referred to as the "Rainy Day Fund," was created to assist in stabilizing revenue and employment during periods of economic recession and high unemployment.

The School Aid Fund's purpose is to aid in the support of the public schools and the intermediate school districts.

The State reports the following major enterprise funds:

The State Lottery Fund accounts for the operations of the State's lottery, bingo, and charitable game operations.

The Michigan Unemployment Compensation Funds receive contributions from employers and provide benefits to eligible unemployed workers.

Additionally, the State reports the following fund types:

Governmental Fund Types:

Special Revenue Funds - include operating fund activities financed by specific revenue sources that are legally restricted for specified purposes. Examples include conservation, transportation, regulatory, and other activities.

Debt Service Funds - account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Capital Projects Funds - account for the acquisition or construction of major State capital facilities financed by bond proceeds and commercial paper notes.

Permanent Funds - report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that benefit the government or its citizenry, such as veterans, child abuse and neglect prevention, state park preservation, and others.

Proprietary Fund Types:

Enterprise Funds - report the activities for which fees are charged to external users for goods or services, such as the State's liquor sales. This fund type is also used when the activity is financed with debt that is secured by a pledge of the net revenues from the fees.

Internal Service Funds - provide goods or services primarily to other agencies or funds of the State, rather than to the general public. These goods and services include prisoner-built office furnishings; motor pool services; printing, reproduction and mailing services; information technology; risk management; and health-related fringe benefits. In the government-wide statements, internal service funds are included with governmental activities.

Fiduciary Fund Types:

Pension (and other employee benefit) Trust Funds - report resources that are required to be held in trust for the members and beneficiaries of the State's defined benefit pension plans, defined contribution plans, and other postemployment benefit plans.

Private Purpose Trust Funds - report resources of all other trust arrangements in which principal and income benefit individuals, private organizations, or other governments. Examples include the State's Escheats Fund, gifts to the State, worker disability monies, and others.

Agency Funds - report assets and liabilities for deposits and investments entrusted to the State as an agent for others.

D. Fiscal Year-Ends

All funds and discretely presented component units are reported using fiscal years which end on September 30, except for the Michigan State Housing Development Authority and the ten State universities, which utilize June 30 year-ends.

E. Assets, Liabilities, and Net Assets/Fund Balance

Cash and Cash Equivalents

On the Statement of Cash Flows, the amount reported as "Cash and cash equivalents" is equal to the total of the amounts on the Statement of Net Assets "Cash" and "Equity in Common Cash," less the amount of "Warrants outstanding."

Cash

Cash reported on the Statement of Net Assets and the Balance Sheet consists of petty cash, undeposited receipts, deposits in transit to the Common Cash pool, and cash equivalents such as short-term investments with original maturities of less than three months that are used for cash management, rather than investing activities.

Equity in Common Cash

The State Treasurer maintains centralized management of most State cash resources (not including component units). From the perspective of the various State funds, the pool functions as both a cash management pool and a demand deposit account. The operations and investments of the Common Cash pool are described in Note 5.

Taxes Receivable

Taxes receivable represent amounts due to the State at September 30, which will be collected sometime in the future. In the government-wide financial statements, a corresponding amount is recorded as revenue. In the governmental fund financial statements, the portion considered "available" (i.e., received by the State within approximately 60 days after year-end) is recorded as revenue; the remainder is recorded as deferred revenue. Application of the measurability and availability criteria regarding taxes is described in Note 6.

Amounts Due From Federal Agencies

For most federally funded programs, revenue is accrued in the same period as related obligations are recorded. In certain programs financed entirely by the federal government, expenditures and related revenues are recognized only to the extent of billings received by fiscal year-end. This treatment, which is generally limited to certain programs within the Department of Education, understates both assets and liabilities, and expenditures and revenues; however, there is no impact on net assets or fund balance.

Inventories

Inventories are valued at cost, primarily using the first-in, first-out flow method. Expenditures (governmental funds) and expenses (proprietary funds) are recognized using the consumption method (i.e., when used or sold).

Investments

Generally, investments are reported at fair value, consistent with the provisions of GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. Short-term, highly liquid debt instruments including commercial paper, banker's acceptances, and U.S. Treasury obligations are reported at amortized cost. Additional disclosures describing investments are provided in Note 8.

Security Lending Collateral

Securities on loan for cash collateral are reported in the Statement of Net Assets. Liabilities resulting from the security lending transactions are also reported. Additional disclosures describing security-lending transactions are provided in Note 8.

Other Assets

Other assets include receivables, amounts held in escrow, and other types of assets not reported on other lines.

Mortgages and Loans Receivable

Mortgages and loans receivable are reported net of unamortized premiums, discounts, deferred loan origination fees, and allowances for possible losses.

Capital Assets

Capital assets, which include land, buildings, equipment and infrastructure assets (e.g., roads, bridges, ramps, and similar items), are reported in the government-wide statements and applicable fund financial statements. Capital assets that are used for governmental activities are only reported in the government-wide statements. Capital assets are reported at historical cost or, if donated, at the estimated fair market value at the date of acquisition. In some instances, capital asset historical costs were not available; therefore, the costs of these assets at the dates of acquisitions have been estimated.

Interest incurred during construction is only capitalized in proprietary funds. Most capital assets are depreciated over their useful lives, using the straight-line depreciation method. However, the State's significant infrastructure assets utilize an alternative accounting treatment in which costs to maintain and preserve these assets are expensed and no depreciation expense is recorded. This approach is discussed further in the Required Supplementary Information portion of this report.

Additional disclosures related to capital assets and assets acquired through capital leases are provided in Notes 9 and 11, respectively.

Warrants Outstanding

Warrants outstanding represent drafts issued against the State Treasurer's Common Cash pool, which have not yet cleared. These are similar to outstanding checks; however, the issuing funds' balances in the pool are not reduced until warrants are redeemed.

Income Tax Refunds Payable

The amount of collected or accrued personal income tax revenues that will be refunded is estimated and accrued as a General Fund liability. Note 15 more fully describes this liability.

Prize Awards Payable

The State Lottery Fund makes long-term prize awards for certain games, most notably the lotto games. Liabilities for these deferred prize awards are recorded at their present value. At September 30, 2002, prize liabilities of \$952.9 million were reported at a present value of \$683.6 million, using discount rates ranging from 5.5 to 8.5%.

Deferred Revenue

In the government-wide statements and proprietary fund financial statements deferred revenue is recognized when cash, receivables, or other assets are received prior to their being earned. In the governmental fund statements deferred revenue is recognized when revenue is unearned or unavailable.

Long-Term Liabilities

In the government-wide statements and proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds, are reported as debt service expenditures.

Long-term liabilities are more fully described in Notes 12, 13, and 14.

Compensated Absences

In the government-wide statements and proprietary fund financial statements, compensated absences are reported as liabilities as required by GASB.

Employees accumulate annual leave (vacation) balances to maximum amounts ranging from 256 to 316 hours. They receive a 100% termination payment upon separation based upon their final rate of pay. The liability for annual leave is valued at 100% of the balance plus the State's share of social security and retirement contributions.

Employee sick leave balances accumulate without limit. Termination payments are made only upon separation from State service and only to employees hired prior to October 1, 1980. Payments at retirement or death are based on 50% of the employee's sick leave accumulation, times their last rate of pay. When separating for any other reason, employees are paid a percentage of their unused sick leave that increases from 0 to 50%, depending upon the balance of their sick leave hours. Sick leave is valued, as explained in the previous paragraph, at 0 to 50% plus the State's share of social security contributions, based on the pay rates in effect as of September 30, 2002.

In the governmental fund financial statements, liabilities for compensated absences are accrued when they are considered "due and payable" and recorded in the fund only for separations or transfers that occur before year-end.

Net Assets/Fund Balance

The difference between fund assets and liabilities is "Net Assets" on the government-wide, proprietary, and fiduciary fund statements, and "Fund Balance" on governmental fund statements.

Reservations

Fund balances for governmental funds are classified as either reserved or unreserved in the fund financial statements. Reserved fund balances reflect either: 1) funds legally segregated for a specific use or 2) assets which, by their nature, are not available for expenditure. Unreserved fund balances reflect the balances available for appropriation for the general purposes of the fund. Note 21 provides a disaggregation of reserved fund balances.

F. Revenues and Expenditures/Expenses

In the government-wide Statement of Activities, revenues and expenses are segregated by activity (governmental or business-type), then further by function (e.g. general government, education, transportation, etc). Additionally, revenues are classified between program and general revenues. Program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues, rather than as program revenue. General revenues include all taxes. Certain indirect costs are included in the program expenses reported for individual functions.

In the governmental fund financial statements, revenues are reported by source. For budgetary control purposes, revenues are further classified as either "general purpose" or "restricted." General purpose revenues are available to fund any activity accounted for in the fund. Restricted revenues are, either by State law or by outside restriction (e.g., federal grants), available only for specified purposes. Unused restricted revenues at year-end are recorded as reservations of fund balance. When both general purpose and restricted funds are available for use, it is the State's policy to use restricted resources first.

In the governmental fund financial statements, expenditures are reported by character: "Current," "Capital outlay," "Intergovernmental-revenue sharing," or "Debt service." Current expenditures are subclassified by function and are for items such as salaries, grants, supplies, and services. Tax expenditures, which represent income tax credit programs that are in substance grants, are also reported as current expenditures. These are described in more detail in Note 15.

Capital outlay includes expenditures for capital assets. Intergovernmental-revenue sharing accounts for the distribution of certain tax revenues that are shared with local units based upon constitutional and statutory requirements. Debt service includes both interest and principal outlays related to bonds and payments on capitalized leases.

Revenues and expenses of proprietary funds are classified as operating or nonoperating and are subclassified by object (e.g., salaries, depreciation, and purchases for resale). Operating revenues and expenses generally result from providing services and producing and delivering goods. All other revenues and expenses are reported as nonoperating.

Other Financing Sources

These additions to governmental fund balances in the fund financial statements include resources and financing provided by bond proceeds, capital leases, and transfers from other funds.

Reimbursements

Reimbursements result when a fund originally making a disbursement receives resources from another fund to which the expenditure/expense is more properly attributable. For example, the State uses this method when the administrative costs of proprietary funds, discretely presented component units, or pension (and other employee benefit) trust funds are appropriated in the General Fund.

Interfund Services Provided and Used

When a sale or purchase of program-related goods and/or services between funds occurs, for a price approximating their external exchange value, the seller reports revenue and the purchaser expenditure or expense, depending upon the fund type.

Transactions between the primary government and a discretely presented component unit are generally classified as revenues and expenses, unless they represent repayments of loans or similar activities.

Other Financing Uses

These reductions of governmental fund resources in fund financial statements normally result from transfers to other funds.

G. Interfund Activity and Balances

Interfund Activity

As a general rule, the effect of interfund activity has been eliminated from the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities (examples include the transfers of profits from the Liquor Purchase Revolving Fund to General Fund and the Lottery Fund to the School Aid Fund) and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column (examples include activities between the Department of Treasury [general government line] and the Department of Education [education line]). Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

In the fund financial statements, transfers represent flows of assets (such as goods or cash) without equivalent flows of assets in return or a requirement for repayment. In addition, transfers are recorded when a fund receiving revenue provides it to the fund which expends the resources. An example is gas taxes collected by the Department of Transportation but expended by the Department of Natural Resources.

Interfund Balances

Interfund receivables and payables have been eliminated from the Statement of Net Assets, except for the residual amounts due between governmental and business-type activities.

NOTE 2 – FUNDS AND COMPONENT UNITS BY CLASSIFICATION

The following table lists all of the funds and component units whose balances are reflected in this financial report.

Operating funds which are subject to annual appropriation and for which budget and actual schedules are included in this report are

identified by an “*”. For each fund or component unit listed, the SOMCAFR page number of the first financial statement for that fund or component unit is shown in parenthesis.

PRIMARY GOVERNMENT:

MAJOR FUNDS

Governmental:

General Fund* (p. 20)
Counter-Cyclical Budget and Economic Stabilization Fund* (p. 20)
School Aid Fund* (p. 20)

Proprietary:

State Lottery Fund (p. 26)
Michigan Unemployment Compensation Funds (p. 26)

NON-MAJOR FUNDS

Governmental:

Special Revenue Funds:

Transportation Related:

State Aeronautics Fund* (p. 100)
State Trunkline Fund* (p. 100)
Michigan Transportation Fund* (p. 100)
Comprehensive Transportation Fund* (p. 100)
Combined State Trunkline Bond Proceeds Fund (p. 101)
Combined Comprehensive Transportation Bond Proceeds Fund (p. 101)
Transportation Related Trust Funds (p. 101)

Conservation, Environment, and Recreation Related:

Game and Fish Protection Fund* (p. 110)
Michigan State Waterways Fund* (p. 110)
Marine Safety Fund* (p. 110)
Game and Fish Protection Trust Fund (p. 110)
State Park Improvement Fund* (p. 110)
Combined Recreation Bond Fund - Local Projects (p. 111)
Combined Environmental Protection Bond Fund (p. 111)
Michigan Nongame Fish and Wildlife Fund* (p. 111)
Forest Development Fund* (p. 111)
Michigan Underground Storage Tank Financial Assurance Fund (p. 111)
Bottle Deposits Fund (p. 111)

Regulatory and Administrative Related:

Michigan Employment Security Act – Administration Fund* (p. 120)
Safety Education and Training Fund* (p. 120)
Uninsured Employers’ Security Fund (p. 122)
State Construction Code Fund* (p. 120)
Homeowner Construction Lien Recovery Fund* (p. 120)
State Casino Gaming Fund* (p. 121)
Second Injury Fund (p. 121)
Silicosis, Dust Disease, and Logging Industry Compensation Fund (p. 121)
Self-Insurers’ Security Fund (p. 121)
Utility Consumer Representation Fund (p. 121)

Other State Funds:

School Bond Loan Fund (p. 130)
Tobacco Settlement Trust Fund* (p. 130)
Michigan Merit Award Trust Fund* (p. 130)
Assigned Claims Facility and Plan Fund (p. 131)
Miscellaneous Special Revenue Funds (p. 131)

Debt Service Funds:

Combined State Trunkline Bond and Interest Redemption Fund (p. 138)
Combined Comprehensive Transportation Bond and Interest Redemption Fund (p. 138)
Recreation and Environmental Protection Bond Redemption Fund (p. 138)
School Loan Bond Redemption Fund (p. 139)
State Building Authority (p. 139)
Michigan Underground Storage Tank Financial Assurance Finance Authority (p. 139)

Capital Projects Funds:

Combined Recreation Bond Fund - State Projects (p. 144)
Advance Financing Funds (p. 144)
State Building Authority (p. 144)

Permanent Funds:

Michigan Natural Resources Trust Fund* (p. 148)
Michigan State Parks Endowment Fund* (p. 148)
Michigan Civilian Conservation Corps Endowment Fund* (p. 148)
Michigan Veterans’ Trust Fund* (p. 149)
Children’s Trust Fund* (p. 149)

Proprietary:

Enterprise Funds:

Liquor Purchase Revolving Fund (p. 26)

Internal Service Funds:

Correctional Industries Revolving Fund (p. 156)
Motor Transport Fund (p. 156)
Office Services Revolving Fund (p. 156)
Information Technology Fund (p. 157)
Risk Management Fund (p. 157)
State Sponsored Group Insurance Fund (p. 157)

Fiduciary:

Pension (and other employee benefit) Trust Funds:

State Employees’ Deferred Compensation Funds (p. 164)
Legislative Retirement Fund (p. 164)
State Police Retirement Fund (p. 164)
State Employees’ Retirement Fund (p. 165)
Public School Employees’ Retirement Fund (p. 165)
Judges’ Retirement Fund (p. 165)
State Employees’ Defined Contribution Retirement Fund (p. 165)

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Private Purpose Trust Funds:

Escheats Fund (p. 170)
Gifts, Bequests, and Deposits Investment Fund (p. 170)
Hospital Patients' Trust Fund (p. 170)
Federal Housing Administration Mortgages Escrow Fund (p. 171)
Michigan Education Savings Program (p. 171)
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Agency Funds:

Environmental Quality Deposits Fund (p. 175)
Insurance Carrier Deposits Fund (p. 175)
State Treasurer's Escrow and Paying Agent Fund (p. 175)
Child Support Collection Fund (p. 175)

DISCRETELY PRESENTED COMPONENT UNITS:

Authorities:

Major Funds:

Michigan Education Trust (p. 36)
Michigan State Housing Development Authority (p. 36)
Michigan Municipal Bond Authority (p. 36)

Non-Major Funds:

Mackinac Bridge Authority (p. 180)
Mackinac Island State Park Commission (p. 180)
Michigan Broadband Development Authority (p. 180)
Michigan Economic Development Corporation (p. 180)
Michigan Higher Education Assistance Authority (p. 180)
Michigan Higher Education Facilities Authority (p. 181)
Michigan Higher Education Student Loan Authority (p. 181)
Michigan Public Educational Facilities Authority (p. 181)
Michigan State Hospital Finance Authority (p. 181)
Michigan Strategic Fund (p. 181)
State Bar of Michigan (p. 181)

- (1) Michigan State University, the University of Michigan, and Wayne State University are not included in the State's reporting entity because they have separately elected governing boards and are legally separate from the State.

State Universities (1):

Major Funds:

Central Michigan University (p. 37)
Western Michigan University (p. 37)

Non-Major Funds:

Eastern Michigan University (p. 186)
Ferris State University (p. 186)
Grand Valley State University (p. 186)
Lake Superior State University (p. 186)
Michigan Technological University (p. 187)
Northern Michigan University (p. 187)
Oakland University (p. 187)
Saginaw Valley State University (p. 187)

The State provides significant funding to support these institutions; however, under the GASB Statement No. 14 criteria, they are considered fiscally independent special-purpose governments.

NOTE 3 – BUDGETING AND BUDGETARY CONTROL, AND LEGAL COMPLIANCE

A. Major Constitutional and Statutory Provisions

Balanced Budget Requirements

Article 5 of the State Constitution mandates that the executive budget recommend spending limits for operating funds to the Legislature that are within available resources. Compliance with this is demonstrated in the executive budget and budget bills for each fiscal year.

Article 4 of the State Constitution mandates the Legislature to enact appropriations for each operating fund that do not exceed that fund's revenue estimates, including beginning unreserved fund balance.

Compliance with this requirement is demonstrated in schedules included in the annual appropriation acts, usually the "General Government" appropriation act. When it appears that revenue will fall below the estimates on which the appropriations are based, the Governor is required to recommend spending reductions as necessary to avoid a year-end deficit.

Local Spending Requirements

Article 9, Section 30 of the State Constitution requires that State spending to, or on behalf of, local units of government shall not fall below a specified percentage of total State spending. The percentage, recalculated effective with fiscal year 1992-1993, is 48.97 %.

Final calculations establishing the State's compliance with this constitutional provision for fiscal year 2001-2002 are not yet

complete. For fiscal year 2000-2001, the most recent year for which final calculations are available, the proportion of total State spending paid to local units of government was determined to be 62.77%, reflecting payments that exceeded the minimum required by \$3.4 billion. The State expects that payments to local units of government will exceed the minimum requirement for fiscal year 2001-2002.

Revenue Limits

Article 9, Section 26, of the State Constitution restricts State revenues to a ceiling that is based upon revenues as a proportion of total personal income for the State. The base year ratio, determined in fiscal year 1978-1979, in relation to calendar year 1977 personal income, is 9.49%. Both the constitutional language and implementing statutes provide for other adjustments to the revenue and personal income calculations. If revenues exceed the limit by 1% or more, the amount in excess must be refunded to personal income tax payers and payers of the State's single business tax. If the limit is exceeded by an amount less than 1%, the excess may be deposited into the State's Budget Stabilization Fund. The calculations determining the State's compliance with this constitutional provision for fiscal year 2001-2002 are not final. For fiscal year 2000-2001, the most recent year for which final calculations are available, total State revenues subject to this limitation were beneath the constitutional limit by \$2.4 billion. The State expects that total State revenues subject to the limitation will not exceed the limit for fiscal year 2001-2002.

Budget Stabilization Fund

The Counter-Cyclical Budget and Economic Stabilization Fund ("Budget Stabilization Fund") was created by P.A. 76 of 1977 to assist in stabilizing revenue and employment during periods of economic recession. In general, the law requires payments into the fund when real economic growth exceeds 2% and allows withdrawals from the fund when real economic growth is less than 0%. Funds can also be withdrawn when the State's unemployment rate exceeds 8% or upon appropriation to finance capital outlay or other projects, or for other purposes designated by the Legislature.

The following table summarizes the transactions for the fund for fiscal year 2001-2002 (in millions):

Beginning unreserved fund balance	\$ 994.2
Interest income	20.8
Transfers to General Fund	(452.8)
Transfers to School Aid Fund	(382.0)
Transfers to State Trunkline Fund	(35.0)
Ending unreserved fund balance	<u>\$ 145.2</u>

Transfers to the General Fund represent the transfer of \$335.0 million pursuant to P.A. 504 of 2002, Section 353c(12), and the transfer of \$117.8 million, pursuant to P.A. 504 of 2002, Section 353c(14). These transfers were made to ensure a balanced General Fund budget. Transfers to the School Aid Fund represent the transfer of \$350.0 million pursuant to P.A. 504 of

2002, Section 353(13), and the transfer of \$32.0 million, pursuant to P.A. 144 of 1997, Section 3. These transfers were made for the purpose of making appropriations to school districts and intermediate school districts as required by P.A. 431 of 1984, as amended. The transfer of \$35.0 million to the State Trunkline Fund is for the purpose of funding a portion of the Build Michigan III program, pursuant to P.A. 189 of 2000, Section 358(3).

Budgetary Overexpenditures

In the event that expenditures exceed authorization during a year, the department must request a supplemental appropriation for the amount overspent, if that amount exceeds their lapses or if they expect to make payments from prior year authorization in the next fiscal year. There were no net overexpenditures by General Fund departments. There were, however, the following line-item overexpenditures of State departments incurred during the year, which represent non-compliance with State budget laws (in millions):

General Fund	
Community Health	\$.1
Family Independence Agency	1.5
General Fund Total	<u>\$ 1.6</u>

NOTE 4 – RESTATEMENTS

The Michigan Higher Education Assistance Authority, a discretely presented component unit, increased its beginning net assets by \$729 thousand to reflect the balances associated with scholarship and grant activity now being accounted for by the Authority.

Oakland University, a discretely presented component unit, reduced its beginning net assets by \$2.0 million to reflect a change in classification of balances associated with Federal Perkins Loans.

NOTE 5 – TREASURER'S COMMON CASH

A. General Accounting Policies

The State Treasurer manages the State's Common Cash pool, which is used by most state funds. The pooling of cash allows the Treasurer to invest monies not needed to pay immediate obligations so that investment earnings on available cash are maximized. Investments of the pool are not segregated by fund; rather, each contributing fund's balance is treated as equity in the pool. Many funds, including pension (and other employee benefit) trust funds, use their equity in the pool as a short-term investment vehicle. The Treasurer separately publishes the "Annual Report of the State Treasurer" which includes audited schedules of Common Cash Assets and Equities, Investment Portfolios of Specific Funds, and Investment Earnings.

In this report, the Common Cash pool is not reported as a separate fund. Instead, each State fund's balance in the pool is presented as "Equity in Common Cash."

All negative balances in the pool are reclassified at year-end as Interfund liabilities. If the negative balance is considered long-term, the reclassification is recorded as an advance.

Statute or administrative policy determines whether a particular fund receives or pays interest on its balances in the pool. If a fund does not receive or pay interest, the General Fund receives or absorbs such amounts. Earnings on positive

balances and charges on negative balances are allocated quarterly based upon the average daily balances of the various funds and the average investment earnings rate for the quarter. Accrued earnings of the pool are recorded as assets, with the accrual allocated to the various funds' equity in the pool. Interest revenues on positive balances and interest charges on negative balances are reflected as revenues or expenditures/expenses of each of the participating funds.

B. Investments and Deposits

The investment authority for the Common Cash pool is found in P.A. 105 of 1855, as amended. The State Treasurer may invest surplus funds belonging to the State in the bonds, notes, and other evidences of indebtedness of the United States Government, and its agencies; and in prime commercial paper. Certificates of deposit are permitted in financial institutions whose principal office is located in the State.

The Treasurer invests excess cash in short-term investments, mostly prime commercial paper. The law does not prohibit the Treasurer from entering into repurchase agreements; however, the Treasurer did not use these agreements in managing the pool in fiscal year 2001-2002.